the first *fifty years* the next

AAR CORP. 2001 Annual Report

fifty years to build on

AAR began as a vision and a venture with a mere $2,500 in start-up capital. Today, AAR is a market leader in a multi-billion dollar industry—the largest, independent provider of diversified products and services to the global aviation/aerospace industry. Our specialty is as broad as it is specific: to seamlessly integrate and deliver highly focused supply chain management through a wide range of product and logistical solutions.

AAR has built a distinctive base of more than 13,000 customers including major commercial and regional airlines; military and governments; MRO and leasing companies; corporate and general aviation operators; and original equipment manufacturers.

With the solid fundamentals of the present and the strong foundation of the past, there is a wealth of opportunity to build on at AAR for the next 50 years and beyond.

"We remain focused on what we do well—staying in front of the customer, providing value-added solutions, maintaining prudent financial management and making investments to drive long-term shareholder value."

DAVID P. STORCH
President and Chief Executive Officer

To our Stockholders, Customers, and Employees

As we entered the pre-summer flying season of 2000, the business climate within the aviation/aerospace industry began to rapidly deteriorate. Rising fuel and labor costs coupled with the impact of a softening world economy led to a significant drop in airline profitability. Furthermore, many of our competitors struggled financially, with some having to file for bankruptcy.

Amid the market volatility and change, AAR arrived at a significant milestone. Fiscal 2001 marked our fiftieth year in business serving the global aviation/aerospace industry. We are proud of this milestone and consider it a privilege to have contributed to the industry's growth over this period.

During it's history, one of AAR's key strengths has been the ability to reinvent itself in response to major market shifts. We have a history of adapting to changing markets. The Company was founded before the jet age and transitioned into jet aircraft support. We dealt with the first major fuel crisis in the early 1970's and the move from first generation to second generation jet aircraft in the early 1980's. We successfully managed through several down cycles, including the airline depression in the early 1990's. And today, we are working through the effects of declining airline profitability and the transition to the latest technology aircraft.

I am confident that we will successfully navigate through the current cycle. We remain focused on what we do well — staying in front of the customer, providing value-added solutions, maintaining prudent financial management and making investments to drive long-term shareholder value.

The entire Company has worked hard to overcome market conditions. We implemented many strategic sales and operational initiatives—ending the year with an overall improvement in results. We achieved our objective of sequential earnings per share improvement for each quarter of fiscal 2001. The Company also achieved record cash flow from operations—our twelfth consecutive year of positive cash flow from operations. For the year, improved cash management allowed us to reduce our average borrowings and lower interest expense.

We aligned our business units and redirected our sales and marketing efforts to improve upon our 'close to the customer' business model. During the year, we created customer loyalty teams and developed a measurement system to enable us to serve our customers more effectively. Already, we can see how these efforts are creating synergies between business units, allowing us to combine our strengths and capabilities to serve our customers in a more powerful manner.

The impact from the loss of the GE Engine Services inventory management programs was considerable. However, we were able to negotiate a favorable exit from these GE contracts, allowing us to reduce our investment in older technology products. And, because many of our strategic sales initiatives were in place, the impact was lessened.

As demand for older generation aircraft and engines decline, we will continue to invest in newer generation inventory and capabilities to drive market opportunities. These investments include expanding our offerings in support of Airbus aircraft and the fast-growing regional jet market, which represent an increasing percentage of the worldwide fleet. Additionally, as major airlines seek cost-effective solutions for maintenance and supply requirements, we continue to deliver 'total solutions' at the best value. Furthermore, as increasing demand for logistics support and outsourcing for the U.S. military continues, we are ready with the right solutions.

New Leadership

Among the highlights of the year, we made a valuable addition to our leadership team with the appointment of Joseph M. Gullion to Executive Vice President and Chief Operating Officer. Joe will be responsible for aligning our business units to satisfy customers, gain market share and drive operational excellence as we execute our business plan. He brings 25 years' experience in aviation services to AAR, most recently as the president of Boeing Airplane Services.

Developing leadership is essential to our success. During the year, we implemented new programs to identify and develop leadership within our organization. We continue to emphasize leadership development as a key element in our ability to achieve our business objectives.

We also elected two new members to our Board of Directors. James G. Brocksmith joined our Board in January 2001. Jim is currently a consultant, having served with KPMG LLP for 31 years where he retired as Deputy Chairman and Chief Operating Officer in 1996. In July 2001, Retired General Ronald R. Fogleman joined the Board after an outstanding career in the U.S. Air Force where he attained the status of Four-Star General, culminating his tenure as Air Force Chief of Staff from 1994 to 1997.

Selected Fiscal 2001 Achievements

Acquisition:

In the second quarter 2001, we acquired Hermetic Aircraft International, previously a wholly owned subsidiary of Honeywell International, Inc. Renamed AAR Hermetic, the company is a long-standing aircraft component repair business that gives AAR new product support opportunities for European manufactured products. We have successfully integrated the business into our network and are pleased with the results.

Growth in Commercial Relationships:

During the year, we were selected by UPS to design and manufacture the main deck cargo loading systems for their fleet of MD-11 freighters and will begin delivery in fiscal year 2002. We won new engine parts inventory management programs with Air France, Delta Air Lines and MTU Maintenance Canada. We also were awarded a ten-year service center agreement by Honeywell as an authorized repair center for the maintenance, repair and overhaul of their environmental control systems in Europe, Asia/Pacific, Africa and most of the Middle East.

Emphasis on newer generation aircraft is an integral part of AAR's future. We signed multi-year contracts to provide landing gear support to United Airlines in support of its fleet of 50 Boeing 777 aircraft. We also signed an agreement with Embraer, the growing regional jet manufacturer, to be its authorized service center for the maintenance and repair of aircraft components.

> *"As major airlines seek cost-effective solutions for maintenance and supply requirements, we continue to deliver 'total solutions' at the best value. As increasing demand for logistics support and outsourcing for the U.S. military continues, we are ready with the right solutions."*

New Military Contracts:

I am also pleased that we were awarded a number of new agreements to support the U.S. military and their major contractors. Through Northrop Grumman, we are providing supply chain management services for the U.S. Air Force E-8 JSTARS program. Teaming with L3 Communications, we are leasing and maintaining two training aircraft for the U.S. Navy TACAMO program. In addition, we were awarded contracts with Dyncorp and Lear Siegler for global repair and overhaul support of 400 propellers for U.S. Army C-12 and U.S. Navy C-26 aircraft.

A Special Thanks

During the year, Erwin Schulze retired from our Board of Directors after 23 years of service. His many contributions have been appreciated and his valuable guidance will be missed. I look forward to continuing our relationship with Erwin and seeking his counsel in the future.

Looking Ahead

As AAR moves into its next fifty years, I believe that the enduring vision and solid principles on which this Company was founded will power us forward. We have a solid franchise in a growth industry and a leadership team dedicated to providing superior returns to shareholders.

I am very proud of the effort put forth by our employees and greatly appreciate the support of our customers. Further, I would like to acknowledge the world class guidance I receive from our Board of Directors. As always, I am thankful to you, our shareholders, for your continued support and I am committed to enhancing your investment.

Sincerely,

David P. Storch

DAVID P. STORCH
President and Chief Executive Officer

August 9, 2001

Many of the world's major, regional and commuter airline operators depend on AAR to provide major maintenance inspections, line maintenance, aircraft modifications and upgrades.

More than 13,000 worldwide customers benefit from AAR's highly personalized service, fast turn times and solid performance guarantees.

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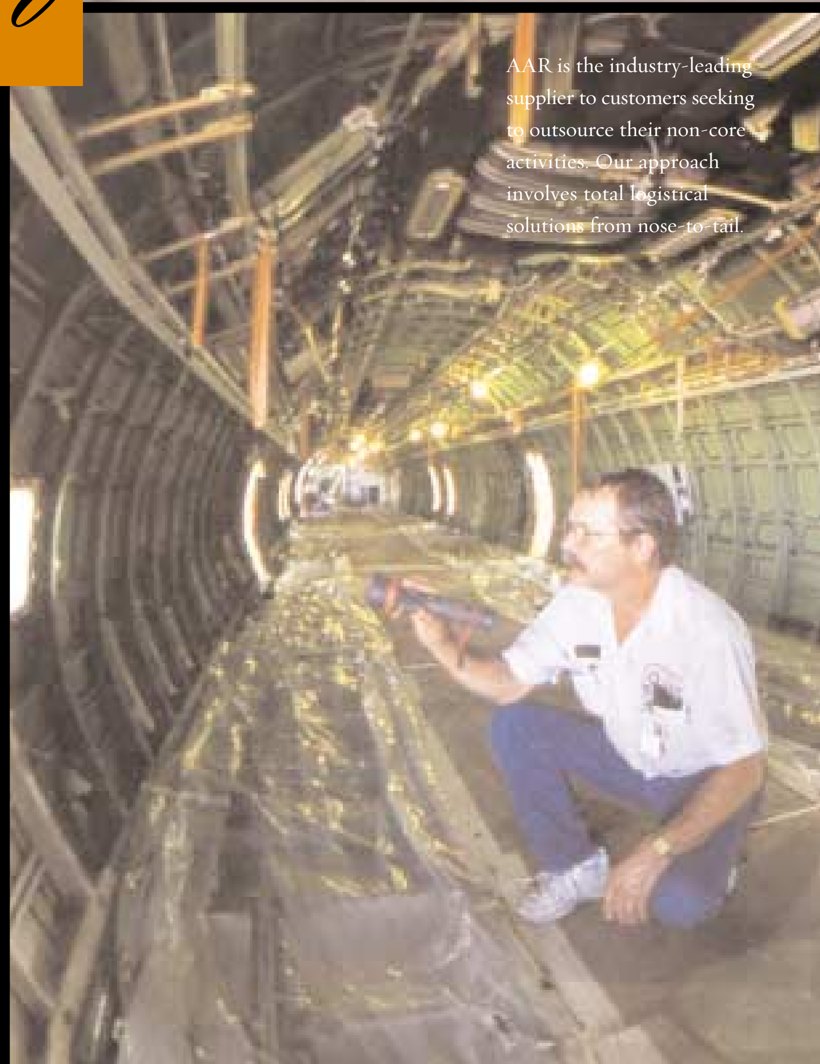
AAR concentrates on serving our customers' needs, from a single spare part to comprehensive supply chain management.



AAR is the industry-leading supplier to customers seeking to outsource their non-core activities. Our approach involves total logistical solutions from nose-to-tail.

years of service

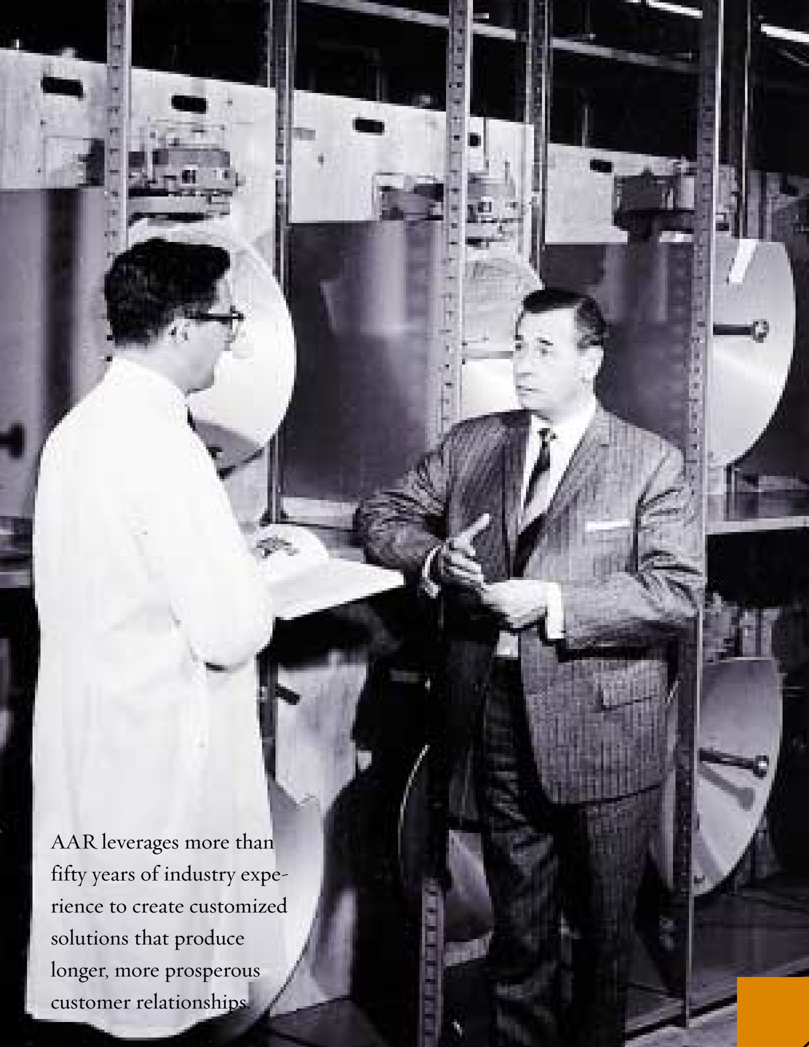
Aircraft demand a constant flow of parts, services and maintenance. In global air transportation alone, there are approximately 14,000 commercial jets in passenger or cargo service. As a result, aircraft operators need problems solved every day—from routine to serious. Handling critical AOGs. Locating hard-to-find parts. Developing landing gear field inspection and repair teams. Leasing engines for immediate lift.

When AAR professionals begin their day, they are focused on what can be done to create solutions and bring more value to the relationship. AAR's top service objective is to help customers maximize their asset and supply chain management, their aircraft uptime and their potential for operational profitability.

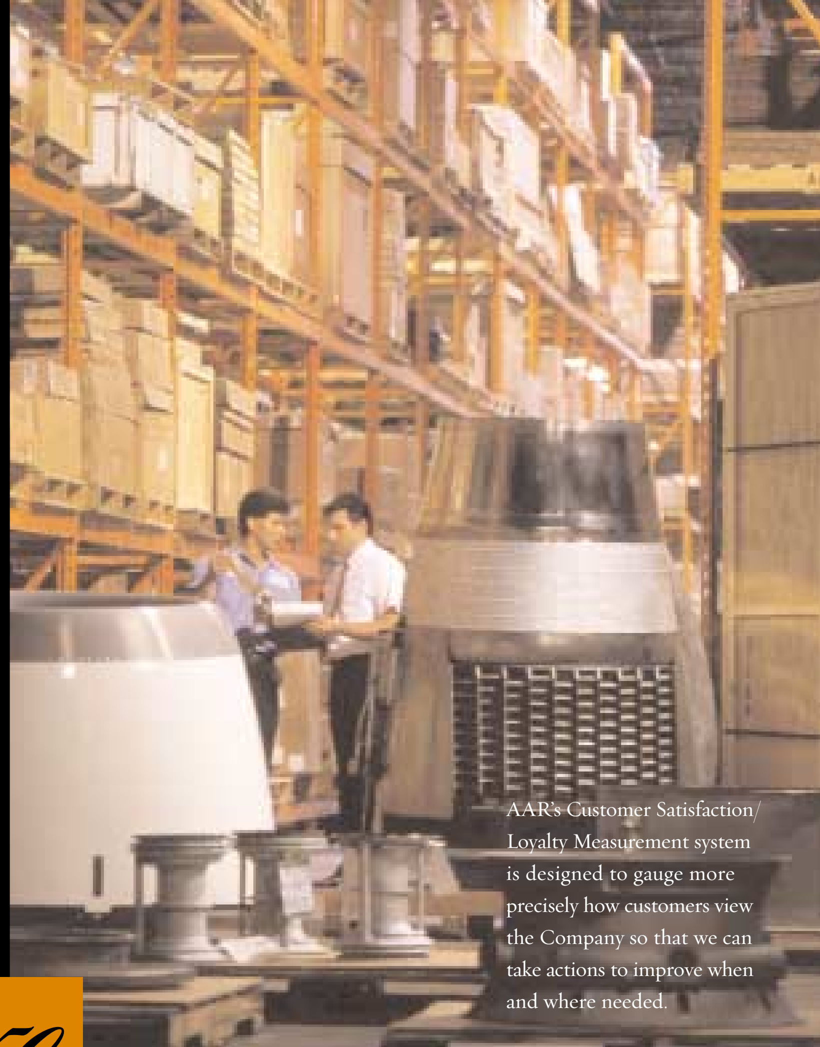
In fact, AAR is given the opportunity to prove itself daily. More and more, customers have chosen to outsource their non-core activities, such as onsite warehouse and inventory management. We are there with total logistical solutions from nose-to-tail.

At the center of our service commitment is the best talent in the business. The management team averages more than twenty years of industry service and experience, much of that time with AAR. The technical staff is trained and licensed in virtually every aspect of the aviation services industry. And, the sales and service staff is motivated to create customers for life.

Over the past five decades, AAR has built proven products, processes and a skilled workforce of 2,500 specialists located at forty facilities around the world. It is a global team serving customers worldwide.



AAR leverages more than fifty years of industry experience to create customized solutions that produce longer, more prosperous customer relationships.



AAR's Customer Satisfaction/Loyalty Measurement system is designed to gauge more precisely how customers view the Company so that we can take actions to improve when and where needed.

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AAR designs innovative products and programs that address needs, enhance profitability and bring value to our customers.

AAR anticipates and responds to continuous change in the $500 billion aviation/aerospace marketplace to best serve our most important asset – the customer.

years of relationships

Staying 'close to the customer' is a guiding principle at AAR. It means working to solve a problem no matter what the hour. It means stretching beyond perceived limitations. It means having integrity and always working in the customer's best interest. And, in our business it means "on-wing" performance.

We believe relationships are about small touches, as well as big issues—whether customers, suppliers, shareholders or employees. A promptly returned phone call. Accurate paperwork. Easy-to-use systems. A personal note when least expected. Ever since AAR's founder, Ira Eichner, sold an aircraft radio to his first customer in the fledging commercial aircraft industry, our Company has worked hard to come up with the right solutions. In doing so, we are rewarded with their relationship and, ultimately, their business.

If we fall short of delivering the best level of service to customers, we regroup, recommit and return to the basics. Our business success depends on customer goodwill and on how effectively we bring value to the customer relationship. That value may be experienced as product innovation, quality service or time and cost savings. However, when it is experienced in a critical moment of customer need, AAR is most successful. Those moments occur daily with AAR professionals who genuinely care about positive customer outcomes.

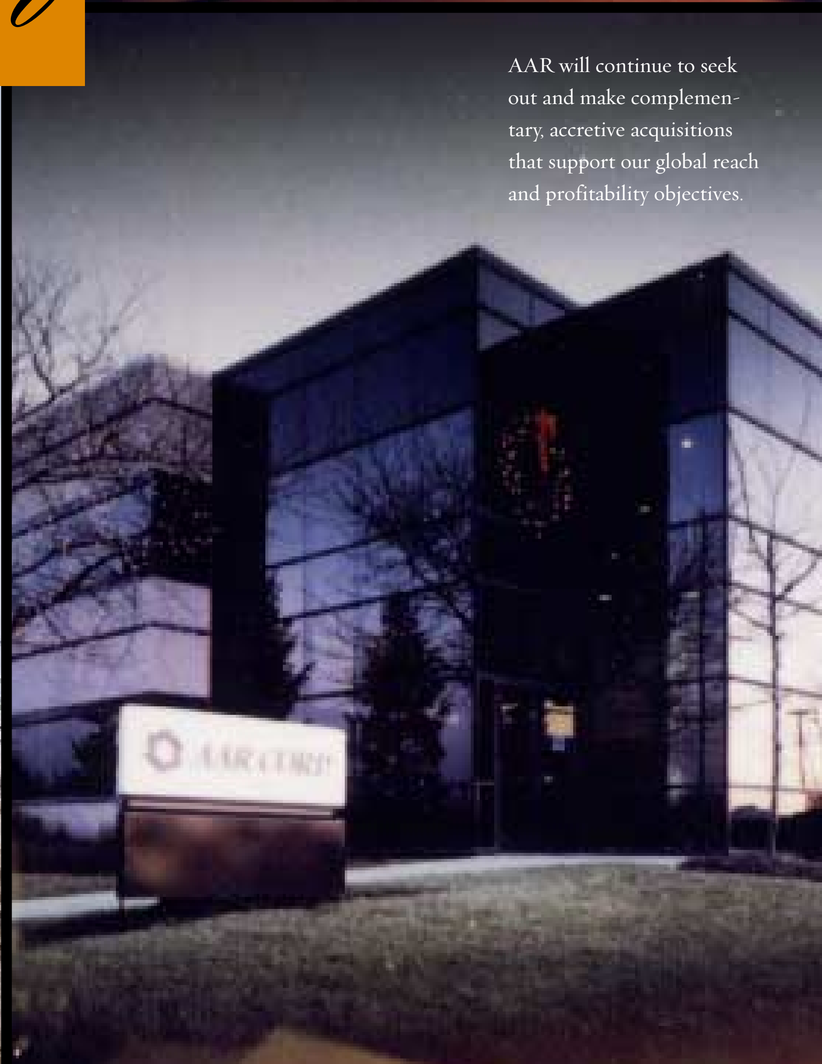
Today, more than 13,000 customers worldwide transact repeat business with AAR. For fifty years, AAR has built many lasting and powerful relationships.

AAR's strategic growth initiatives blend our heritage of entrepreneurial spirit with business possibility.

AAR has been a publicly held company since 1967 and began trading on the New York Stock Exchange in 1980.

In the drive for operational excellence, AAR has invested in expanding facilities, upgrading equipment and developing proprietary systems enabling faster turntimes and improved operating efficiencies.

AAR will continue to seek out and make complementary, accretive acquisitions that support our global reach and profitability objectives.



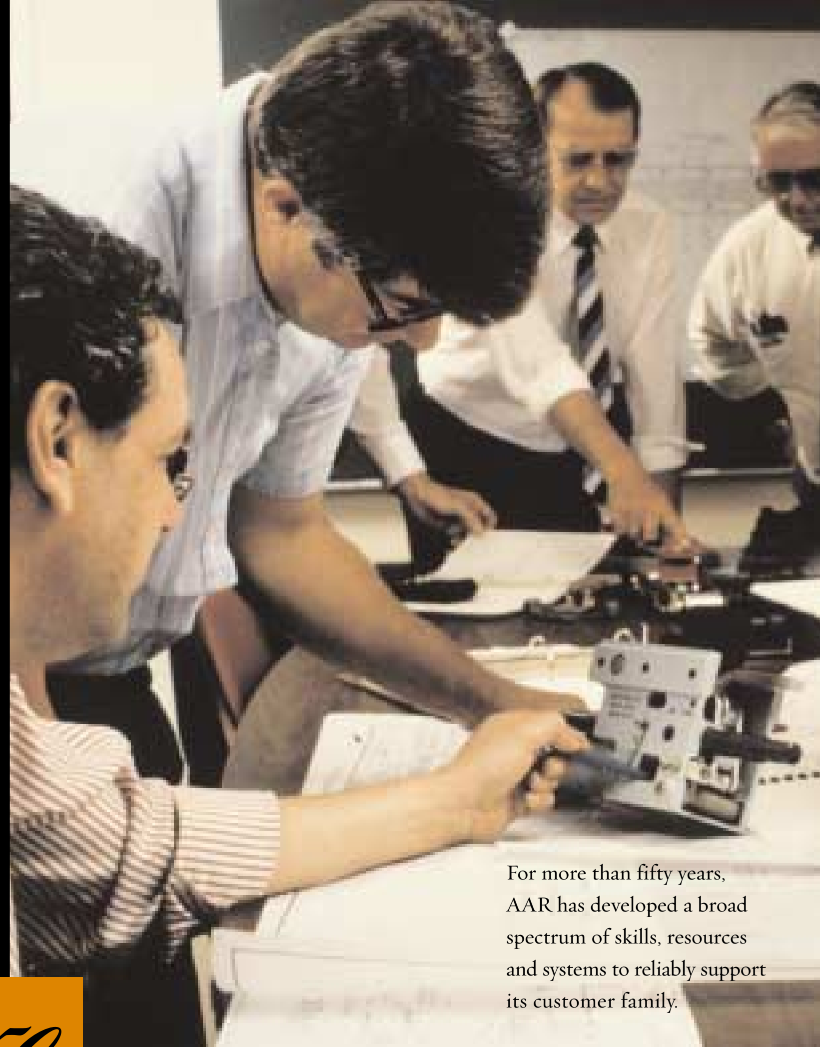
years of results

From the beginning, our goal has been to help customers achieve a direct, bottom-line improvement in their results. Customers can rely on AAR as they reduce costs and free up capital for future investment.

In aviation services, fast turn times and minimal downtime are key to airline dispatch reliability. Optimizing on-wing performance is critical to our customers. In fact, AAR is measured moment to moment on our ability to develop the solution, repair the rotable, manage the inventory and ship the parts on time, on budget, and to customer expectations—all towards the goal of keeping our customers' aircraft in flight.

AAR's systems not only enable customers to check pricing, availability and delivery status; they also allow customized inventory tracking and management. Customized Internet applications have demonstrated promising results for the company, as well as our customers, and the promise of future benefits continues to grow.

AAR has been profitable every year since its founding in 1951. Experience has given the Company the foundation to grow and expand as customers and markets change.



For more than fifty years, AAR has developed a broad spectrum of skills, resources and systems to reliably support its customer family.

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Whomever the customer and whatever the aviation support needs, the depth of AAR's technical experience and financial resources can provide the best, results-producing solution, every time.

A seasoned management team with an average of twenty years of service in the industry provides AAR with guidance and leadership. The depth and breadth of their experience are some of AAR's key advantages.

years of experience

The aviation business is built on trust. And trust is built on the confidence that comes from experience. With fifty years of experience to draw upon, AAR has created a foundation of aviation support unmatched in the industry.

Our background in a wide range of sectors enables us to serve many customer groups effectively. Major commercial and regional airlines worldwide. Military and governments. Maintenance repair organizations. Corporate and general aviation operators. Original equipment manufacturers. Each one requires a special understanding and knowledge that can only be built over time.

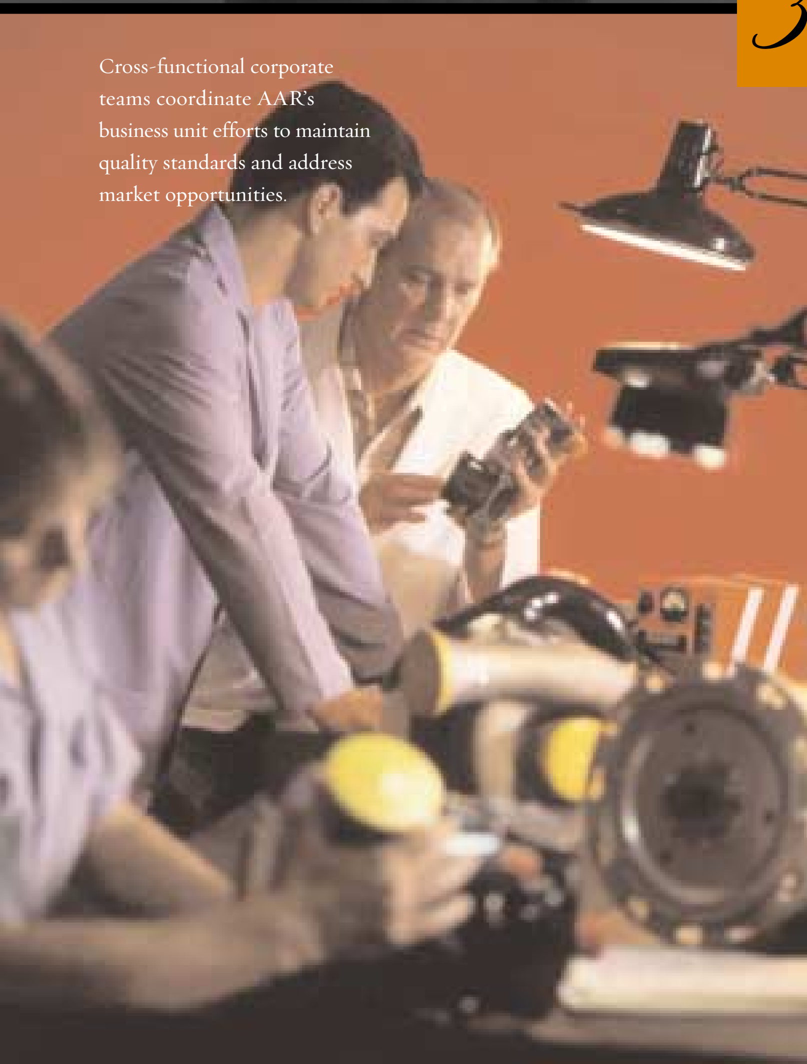
The right supplier choice is crucial to every business. Aviation customers, in particular, cannot afford to risk their performance on merely average-performing vendors. The fact that AAR's customer family is well diversified is an advantage for individual customers, as we have the ability to draw on our broad knowledge and experience to handle any situation that may arise and to further enhance customer results.

Our customer family includes Air France, American Airlines, Boeing, CIT Aerospace, DaimlerChrysler MTU, Delta Air Lines, FedEx, GE, GRUPO TACA, Japan Airlines, KLM, Lufthansa, Northrup Grumman, Southwest Airlines, United Airlines, UPS and the U.S. Government and Armed Forces. All our valuable customers rely on AAR's experience in aviation support services to help them improve service, reduce costs and increase operational efficiency.

Few companies can equal AAR's experience in integrated asset and supply chain management.

AAR has maintained a Class 10.000 Clean Room environment in its Amsterdam component repair facility since 1965.

AAR is a total quality-driven company with a proven track record for engineering, manufacturing and technical excellence across all operating units.



Cross-functional corporate teams coordinate AAR's business unit efforts to maintain quality standards and address market opportunities.

AAR's culture of quality inspires employees to do things right in order to save our customers valuable time and resources.

years of quality

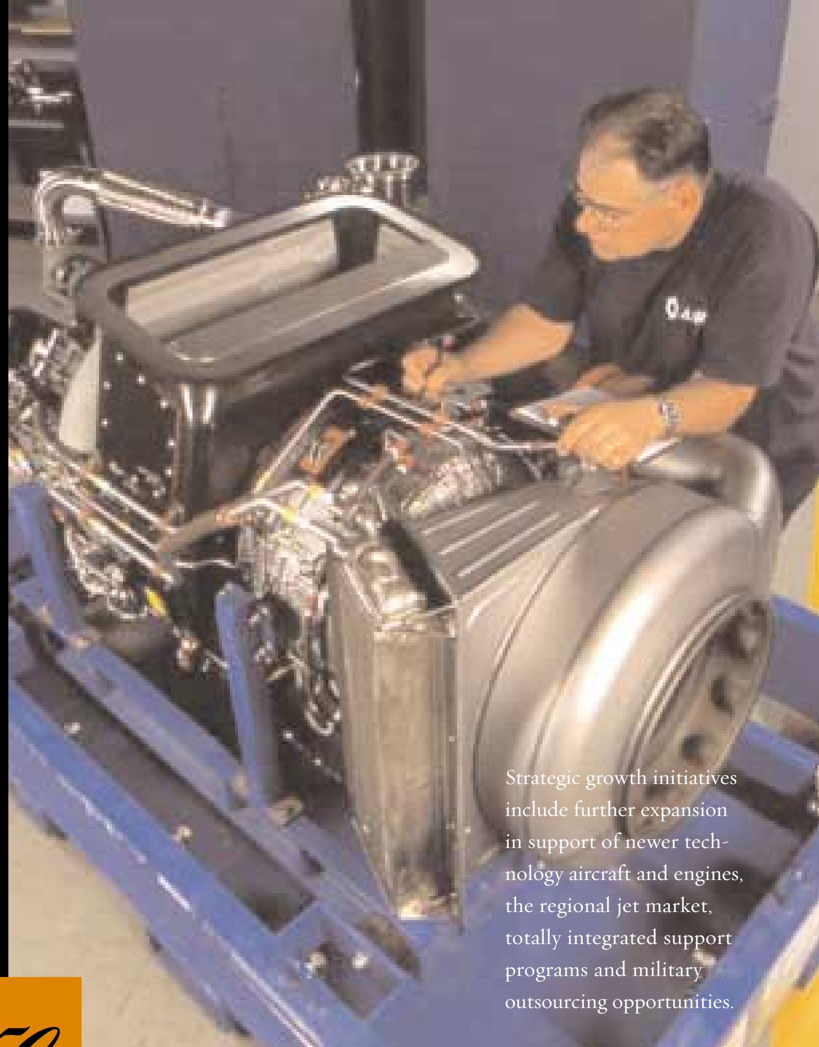
At AAR, safety of flight is paramount to everything we do. Our professionals continually strive for outstanding quality. We may develop a proprietary engineering process to restore new life to a used part, or design a unique, lightweight cargo loading system. Always, AAR taps into an extensive network of quality-driven capabilities and resources to our customers' advantage.

All major AAR operations are ISO 9000-certified. We comply with airline quality control standards, as well as the safety, regulatory and certification standards of the FAA, JAA and CAA agencies. For the U.S. military and government, AAR meets the stringent regulations of the U.S. Department of Defense.

AAR's quality control and safety procedures make certain that only AAR-approved products are delivered to customers. Every part we receive undergoes inspection and documentation review for traceability. When sold, all parts undergo a preshipment inspection. Historical documentation is available for all parts and is provided to customers at their request.

Our proven track record for quality in engineering, manufacturing, technical services and component supply has enabled AAR to meet the high quality standards demanded by our customers and the flying public.

The key to AAR's leadership position is the dedication and expertise of 2,500 employees who believe in the value of what they do for our customers.



Strategic growth initiatives include further expansion in support of newer technology aircraft and engines, the regional jet market, totally integrated support programs and military outsourcing opportunities.

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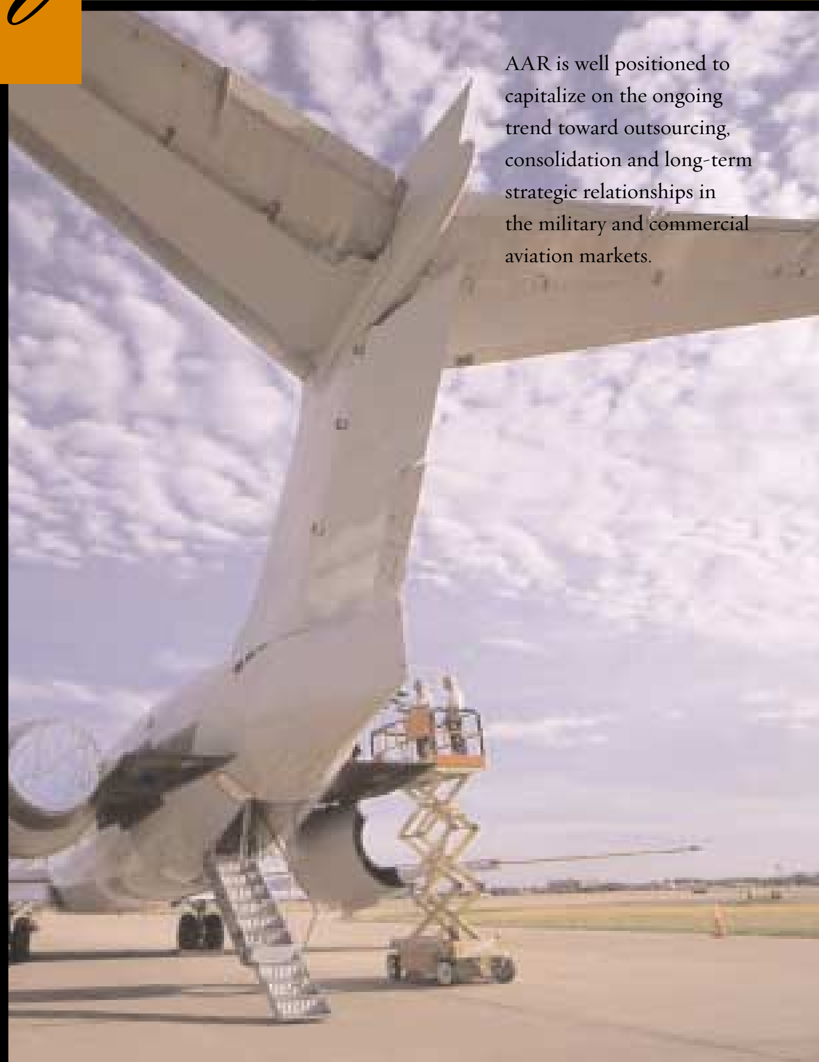
AAR's primary goal for the future is to build, enhance and protect our customers' aviation assets.



AAR is well positioned to capitalize on the ongoing trend toward outsourcing, consolidation and long-term strategic relationships in the military and commercial aviation markets.

years and growing

The aviation/aerospace business is one of the most vital and dynamic industries in the world. It has freed man of his earth-bound restraints. It has broken the sound barrier and put man on the moon. It has touched the lives of virtually everyone on Earth as it continues to melt away boundaries and bring people together.

AAR is fortunate to be a growing part of this industry. We have derived enormous benefit from it since 1951. We have cultivated long-lasting relationships with exceptional people and world-class companies. We have created ideas, products and services that have lasting value. We have provided opportunity for thousands of employees. And, we have generated profitable growth for our shareholders.

Yet, there is much more to accomplish in the years ahead. Over the last century, we have evolved from a small trader of aircraft radios into a global leader in aviation supply and service, continually reinventing and improving ourselves. Undoubtedly, the future will demand continued resilience, product innovation and prudent financial management. And we will deliver.

AAR stands today as a living testimony to a long-ago vision—to help customers profit by building, enhancing and protecting their aviation assets. We will continue to build on our heritage to shape the future.

At-a-glance

AAR has become the largest, independent provider of asset-enhancing products and services to the global aviation/aerospace aftermarket. Our success flows from a single, important concept: consistently deliver total solutions to our customers at the highest possible quality standards.

Aircraft and Engine Sales and Leasing

Airlines regularly alter their fleet composition to meet the demands of changing economics, route systems and passenger preferences. AAR enables airlines to respond rapidly to change by leveraging its direct relationships with all the major aircraft and engine manufacturers to provide immediate solutions with aircraft and engine types to serve the commercial, corporate and military sectors.

Experienced professionals source and evaluate aircraft for acquisition, sale or lease; implement sale, lease and exchange programs for engines; and perform or manage required maintenance, upgrades and conversions. AAR delivers engines to customer specifications, and maintains an extensive inventory of ready-to-deliver engines from CFM International, General Electric, International Aero Engines and Pratt & Whitney. In addition, AAR's expertise in customized financing solutions, including operating leases and existing lease purchases, ensures flexible and comprehensive response to customer needs.

Aircraft Component Repair

AAR repairs, overhauls and maintains rotable components for commercial transport and commuter aircraft from Boeing/McDonnell Douglas, Fokker and Airbus to ATR, BAe, deHavilland, Embraer and SAAB. Our AOG around-the-clock service is delivered with precision at any one of our repair centers in Amsterdam, London and New York. Expert technicians service more than 22,000 high-value rotables including avionics, instruments, hydraulics, pneumatics, electronics, fuel controls and electrical accessories.

AAR offers a wide range of support packages such as flight hour agreements, rotable pooling, leasing and exchange consignments, as well as standard time and material repairs/overhauls.

We also provide aircraft components, engines and auxiliary power units (APUs) through sales, lease and exchange programs, as well as assist with inventory management services.

Aircraft Maintenance, Modification and Services

AAR provides major maintenance inspections, line maintenance, aircraft modifications and upgrades at our internationally certified repair and overhaul facility in Oklahoma City. With more than 200,000 square feet of space and seven hangars, we can support up to six narrow-body aircraft nose-to-tail.

Many of the world's major, regional and commuter airline operators, as well as the U.S. military and government rely on aircraft services at AAR Oklahoma. From major airframe maintenance, inspection and repair; aircraft modification to avionics service and installations; interior and exterior refurbishment; and fuel and storage services, AAR is a full-service aviation partner.

Airframe Parts Supply and Distribution

AAR offers full logistics coverage from private aircraft to transport jets that is supported by an extensive stocking inventory. Our distribution capability is unmatched in the industry. We stock more than 35,000 items of factory-new or refurbished parts, representing 250 equipment manufacturers, and servicing virtually all commercial aircraft variants.

Customers are treated to expert staff, same-day shipping and total quality control. In keeping with our mission to help customers reduce costs and boost efficiency, we offer inventory management and parts exchange programs.

Cargo Loading Systems

AAR designs and manufactures specialized in-aircraft cargo loading systems with a reputation for innovation and rugged durability. At seven percent annually, the global air cargo market is growing faster than passenger traffic, thus presenting ample opportunity for new ventures for AAR.

We work with equal effectiveness on nearly every type of fixed- and rotary-wing aircraft, and offer a complete line of in-aircraft cargo handling systems and components covering more than 40 different airframes and hundreds of STCs and PMAs.

Composites Manufacturing

Weight, noise and useful service life are all pivotal elements in the cost-effective operation of aircraft. AAR has an industry-leading role in the design and manufacture of composite interior and exterior structures for aircraft modification.

Our design and development work helps to reduce cabin noise, increase overall space and extend the life of critical components by producing composite materials known for their exceptional durability, strength and noncorrosive performance.

Engine Component Repair

Our expertise in turbines and component overhaul for aircraft operators, independent overhaul facilities and power-generation companies is built on a reputation for customer satisfaction. The AAR commitment to continuous process improvements and quality standards ensures that we deliver output beyond industry standard.

Overall capabilities include on-site overhaul of industrial steam and gas turbines, replacement parts, blade and valve repair, installation of erosion shields, diaphragm and nozzle coatings, and rotor overhaul and balancing.

Engine Parts Supply

As the largest, independent supplier of aircraft engine parts, few companies can compare to the selection, speed and service of AAR. Airline and aviation customers can take advantage of a broad spectrum of programs such as just-in-time delivery, repair and exchange, onsite warehouse management and inventory management services. As a result, they benefit from program efficiency and lower maintenance costs.

Landing Gear Repair

AAR also specializes in the repair, overhaul and exchange of landing gear for commercial and regional aircraft. Stringent inspection procedures are carried out with on staff FAA Designated Engineering and Airworthiness Representatives. From initial inspection, disassembly and assembly to painting, plating, machining and nondestructive testing, AAR customers can rely on our utmost attention to their valuable assets.

Rapid Deployment Products

An important aspect of our business is service to the U.S. military. We design, manufacture and support an extensive range of components, as well as build test equipment; weapon, cargo and mobility systems; and custom shipping and storage containers. From Planned Depot Maintenance and Integrated Logistics Support to Material Management and rapid deployment products, AAR is regarded as a quality supplier to military and government agencies worldwide.

Board of Directors

Seated

David P. Storch
President and Chief Executive Officer, AAR CORP.

Howard B. Bernick
President and Chief Executive Officer, Alberto-Culver Company

James G. Brocksmith Jr.
Independent Business Consultant
Retired Deputy Chairman and COO, KPMG LLP

Standing

Joel D. Spungin
Managing Partner, DMS Enterprises, L.P.
Chairman Emeritus of United Stationers, Inc.

Ira A. Eichner
Chairman of the Board and Founder, AAR CORP.

Richard D. Tabery
Aviation Business Consultant

Edgar D. Jannotta
Senior Director, William Blair & Company, L.L.C.

Lee B. Stern
President, LBS Co.

A. Robert Abboud
President, A. Robert Abboud & Co.

Not Pictured

Ret. General Ronald R. Fogleman
U.S. Air Force

(dollars in thousands)

Results of Operations

The Company reports its activities in three business segments: Aircraft and Engines, Airframe and Accessories and Manufacturing. The table below sets forth net sales for the Company's three business segments and for pass through sales for each of the last three fiscal years ended May 31.

For the year ended May 31,	2001	2000	1999
Sales:			
Aircraft and Engines	**$337,192**	$ 440,285	$ 416,099
Airframe and Accessories	**419,313**	397,307	376,356
Manufacturing	**97,154**	119,933	125,581
	853,659	957,525	918,036
Pass through sales	**20,596**	66,808	132,572
	$874,255	$1,024,333	$1,050,608

Three-Year Sales Summary

Over the last three fiscal years, consolidated sales, excluding pass through sales, decreased from $918,036 in fiscal 1999 to $853,659 in fiscal 2001. Total sales, which include pass through sales, decreased from $1,050,608 in fiscal 1999 to $874,255 in fiscal 2001. The decline in sales from fiscal 1999 to fiscal 2001 was primarily the result of lower sales from engine parts inventory management programs to a major customer, resulting in a decrease in the Company's Aircraft and Engines sales from $416,099 in fiscal 1999 to $337,192 in fiscal 2001. The sales decline was also influenced by a decline in airline profitability during the three-year period as a result of an overall economic slowdown and higher fuel prices.

The engine parts inventory management programs with a major customer supported older technology JT8D and JT9D engine families which are being phased out of the world airlines' fleets, resulting in softer demand for the spare parts required to maintain these engine types. As demand for these parts by this major customer decreased, the justification for carrying a just-in-time exclusive parts support arrangement became less viable and the program was dissolved by mutual agreement in fiscal 2001. Because all pass through sales were derived from these inventory management programs, pass through sales declined as well.

The sales decline over the three-year period in the Aircraft and Engines segment was partially offset by a sales increase in the Airframe and Accessories segment from $376,356 in fiscal 1999 to $419,313 in fiscal 2001. This increase was the result of new aircraft component repair capability and capacity in both the commercial airline and military aviation markets, and additional penetration of the landing gear overhaul market, including the relatively fast-growing regional aircraft market. In addition, the sales increase from fiscal 2000 to fiscal 2001 reflects the favorable impact of the acquisition of Hermetic Aircraft International (Hermetic) in the second quarter of fiscal 2001.

Sales in the Manufacturing segment declined from $125,581 in fiscal 1999 to $97,154 in fiscal 2001 primarily as a result of reduced demand for the Company's rapid deployment products supporting the U.S. Government, and also the divestiture of the Company's floor maintenance products manufacturing facility in fiscal 1999.

Although commercial airline profitability has significantly declined over the past three years, worldwide air traffic growth, the primary underlying long-term growth factor in the Company's commercial markets, continues to expand, creating future opportunities for the Company. The Company believes that its established position as the leading independent provider of value-added aviation products and services to the worldwide aviation/aerospace industry will enable it to take advantage of continuing market opportunities.*

Fiscal 2001 Compared with Fiscal 2000

Consolidated sales in fiscal 2001, excluding pass through sales, decreased $103,866 or 10.8% compared to the prior year as the Company experienced lower sales in the Aircraft and Engines and Manufacturing segments, partially offset by increased sales in the Airframe and Accessories segment.

In the Aircraft and Engines segment, fiscal 2001 sales declined $103,093 or 23.4% compared to fiscal 2000 primarily as a result of lower revenue in the Company's aircraft sales business and lower sales of engine parts and components. The decline in aircraft sales is mainly due to the type of aircraft sold in the current year compared to the prior year. The decline in engine parts sales was primarily the result of reduced demand by a major customer for certain engine parts due principally to fewer engine shop visits to this customer for the engine types the Company supports, and from the impact of converting the Company's exclusive engine parts support agreement with this major customer to preferred status, which occurred in December 2000. The reduction in pass through sales of

* *This section contains forward-looking statements which are identified with an asterisk (*). Please see comments on forward-looking statement risk factors in the "Forward-Looking Statements" section on page 24.*

$46,212 also was attributable to these factors. Because the exclusive engine parts support agreements with this major customer were dissolved, in future periods the Company does not believe it will have pass through sales.*

In the Airframe and Accessories segment, fiscal 2001 sales increased over the prior year $22,006 or 5.5% primarily as a result of higher sales of airframe parts and from the favorable impact of the acquisition of Hermetic, which the Company acquired on September 29, 2000. Fiscal 2001 revenues for Hermetic included in consolidated sales were approximately $13,100.

In the Manufacturing segment, fiscal 2001 sales declined $22,779 or 19.0% compared to fiscal 2000 primarily as a result of lower sales of products supporting the U.S. Government's rapid deployment program, and lower sales of the Company's cargo systems and composite structure products.

Consolidated gross profit decreased $36,386 or 21.1% over the prior year due to the impact of lower sales and a reduction in the consolidated gross profit margin. The decline in the gross profit margin was attributable to lower margins in the Aircraft and Engines segment due to pricing pressure on older technology engine parts and reduced demand from a major inventory management program customer. Gross profit margins were also lower in the Manufacturing segment reflecting lower demand for certain of the Company's manufactured products. The consolidated gross profit margin was also negatively impacted by a $5,400 provision recorded in the fourth quarter of fiscal 2001 to adjust certain inventories previously used to support the major program customer to their net realizable value.

Selling, general and administrative costs declined $6,118 or 6.0% reflecting lower personnel costs as the Company reduced its cost structure in response to more difficult industry conditions. Selling, general and administrative expense declined also as a result of lower bad debt expense in fiscal 2001 compared to the prior year. Interest expense decreased $1,544 principally as a result of reduced average short-term borrowings outstanding during fiscal 2001. Interest income declined $582 as a result of the reduction in average outstanding interest-bearing trade notes receivable during the current year compared to the prior year.

This section contains forward-looking statements which are identified with an asterisk (*). Please see comments on forward-looking statement risk factors in the "Forward-Looking Statements" section on page 24.

The Company's effective tax rate for fiscal 2001 was 8.4% compared to 29.0% for fiscal 2000. The fiscal 2001 provision for income taxes includes a reduction in income tax expense of $3,300. This adjustment represents the reversal of Federal and state income tax liabilities for years prior to fiscal 1998, now closed to assessments.

Consolidated net income declined $16,632 as a result of the factors discussed above.

Fiscal 2000 Compared with Fiscal 1999

Consolidated sales in fiscal 2000, excluding pass through sales, increased 4.3% to $957,525 from $918,036 in fiscal 1999. This increase was attributable to higher demand in both the Aircraft and Engines and Airframe and Accessories segments.

In the Aircraft and Engines segment, sales increased $24,186 or 5.8% as the Company experienced strong demand for its whole engine and aircraft products, partially offset by a continued decrease in sales from engine parts inventory management programs. This decrease was primarily the result of reduced demand by a major customer for certain engine parts due principally to significantly fewer engine shop visits to this customer for the engine types the Company supported. Pass through sales were $66,808 compared to $132,572 in the prior year. As certain of the Company's inventory management programs matured, pass through sales declined as the Company sourced more of its customer's parts requirements with used serviceable parts, rather than with factory-new parts. The reduction in pass through sales during the fiscal year is attributable to the maturation of the Company's long-term inventory management programs, as well as a decline in the number of shop visits for the engine types the Company supports at certain long-term inventory management programs.

Sales in the Airframe and Accessories segment increased $20,951 or 5.6% reflecting increased demand for the Company's aircraft maintenance and component overhaul and repair services. These increases were partially offset by lower new aircraft parts sales to general aviation customers.

In the Manufacturing segment, sales declined $5,648 or 4.5% as a result of the divestiture of the Company's floor maintenance products manufacturing subsidiary in November 1998, partially offset by higher sales of the Company's products supporting the U.S. Government's deployment needs.

Consolidated gross profit was essentially even with the prior fiscal year. The fiscal 2000 consolidated gross profit margin, excluding the impact from pass through sales, was

18.1%, compared to 18.9% in fiscal 1999. The decrease in the gross profit margin can be attributed to lower margins in the Aircraft and Engines segment due to the unfavorable impact of the mix of inventories sold. Gross profit margins increased in the Airframe and Accessories segment principally due to increased demand for the Company's landing gear and component overhaul and repair services.

Selling, general and administrative expenses increased $6,317 or 6.6% as a result of a $4,000 charge to increase the allowance for doubtful accounts in response to the Company's accounts receivable exposure, which included two airlines that filed for bankruptcy protection during fiscal 2000, as well as increased information technology costs incurred as a result of the Company's e-business activities. Interest expense increased $4,864 principally as a result of increased average short-term borrowings outstanding during fiscal year 2000 compared to fiscal 1999, and interest income increased $1,327 as a result of an increase in average outstanding interest-bearing notes receivable during fiscal 2000 compared to fiscal 1999.

Consolidated net income declined $6,508 or 15.6% from fiscal 1999 as a result of the above factors.

Fiscal 1999 Compared with Fiscal 1998

Consolidated sales in fiscal 1999, excluding pass through sales, increased 17.4% to $918,036 from $782,123 in fiscal 1998. This increase was attributable to continued strong demand for the Company's broad range of products and services and, among other things, full-year sales from businesses acquired in fiscal 1998.

Sales in the Aircraft and Engines segment increased $76,800 or 22.6% resulting from higher sales of engine parts, driven primarily from strength in inventory management programs, and increased aircraft sales and leasing revenues. These increases were partially offset by the impact of certain engine parts sales which were recorded by Turbine Engine Asset Management L.L.C. (an unconsolidated joint venture company) during fiscal 1999, but were recorded by the Aircraft and Engines segment during the first half of fiscal 1998. Pass through sales were $132,572 compared to $74,514 in fiscal 1998. The increase in pass through sales in fiscal 1999 compared to fiscal 1998 was attributable to the addition of new inventory management programs during fiscal 1999 and late fiscal 1998.

Sales in the Airframe and Accessories segment increased $43,073 or 12.9% driven primarily by the impact of full-year sales from the new-parts distribution companies acquired during fiscal 1998, as well as increased demand for aircraft maintenance and landing gear overhaul repair capabilities.

Sales in the Manufacturing segment increased $16,040 or 14.6% due to increased sales of products supporting the U.S. Government's rapid deployment program, the inclusion of full-year sales from AAR Composites (acquired in fiscal 1998) and higher sales of cargo handling systems. These gains were partially offset by the unfavorable impact on sales as a result of the divestiture of the Company's floor maintenance products manufacturing subsidiary in November 1998.

Consolidated gross profit increased $24,853 or 16.7% due to increased consolidated net sales. The fiscal 1999 consolidated gross profit margin of 18.9%, excluding the impact of pass through sales, is slightly less than the consolidated gross profit margin of 19.0% in fiscal 1998. The gross profit margin in the Aircraft and Engines segment remained flat, while the gross profit margin increased in the Company's Manufacturing segment primarily due to increased demand for cargo handling systems. The gross profit margin in the Airframe and Accessories segment declined due to the mix of inventories sold.

Selling, general and administrative expenses were lower as a percentage of consolidated net sales; however, total expenses increased due to the impact from companies acquired during fiscal 1998, as well as increased marketing support and information technology costs, which include Year 2000 compliance costs. Interest expense increased $4,073 or 28.1% over the prior year primarily due to the full-year effect of the $60,000 of unsecured 6.875% Notes issued in December 1997.

Consolidated net income increased $6,014 or 16.9% over the prior year as a result of the above-noted factors.

Liquidity and Capital Resources

At May 31, 2001, the Company's liquidity and capital resources included cash and cash equivalents of $13,809 and working capital of $360,464. At May 31, 2001, the Company's long-term debt-to-capitalization ratio was 34.6% compared to 34.9% at May 31, 2000, and the Company's total debt-to-capitalization ratio was 36.3% at May 31, 2001 compared to 38.1% at May 31, 2000. The reduction in the total debt-to-capitalization ratio was due to lower short-term borrowings outstanding at May 31, 2001 compared to May 31, 2000. The Company continues to maintain its external sources of financing including $125,000 of unused available committed bank lines, and a universal shelf registration on file with the Securities and Exchange Commission under which up to $200,000 of common stock, preferred stock or medium- or long-term debt securities may be issued or sold subject to market conditions, and an accounts receivable securitization program under which the

Company may sell an interest in a defined pool of accounts receivable. At May 31, 2001, accounts receivable, net of retained interest, sold under this arrangement were $18,984, compared to $29,359 at May 31, 2000.

During fiscal 2001, the Company generated $46,093 of cash flow from operations compared to $10,051 and $28,525 during fiscal 2000 and 1999, respectively. The increase in cash flow from operations compared to the prior year was principally due to effective working capital management as the Company reduced its investment in inventories and improved accounts receivable turnover.

During fiscal 2001, the Company's investing activities generated $2,141 of cash. Cash generated from investing activities principally reflects cash received from the sale of the Company's interest in a leveraged lease and cash received in connection with the sale and dissolution of three joint venture companies, offset by property, plant and equipment expenditures of $13,134 and the cash payment for the Hermetic acquisition of $3,200.

During fiscal 2001, the Company's financing activities used $35,616 of cash principally reflecting the reduction of bank lines of $25,885 and the payment of cash dividends of $9,157.

The Company believes that its liquidity and available sources of capital will continue to provide the Company with the ability to meet its ongoing working capital requirements, make anticipated capital expenditures, meet contractual commitments and pay dividends.*

A summary of key indicators of financial condition and lines of credit follows:

May 31,	2001	2000
Working capital	**$360,464**	$347,451
Current ratio	**3.9:1**	3.1:1
Bank credit lines:		
Borrowings outstanding	**$ –**	$ 25,885
Available but unused committed lines	**125,000**	84,115
Total available committed credit lines	**$125,000**	$110,000
Long-term debt, less current maturities	**$179,987**	$180,447
Ratio of long-term debt-to-capitalization	**34.6%**	34.9%
Ratio of total debt-to-capitalization	**36.3%**	38.1%

Forward-Looking Statements

Management's Discussion and Analysis of Financial Condition and Results of Operations contains 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 and are identified by an asterisk(*). These forward-looking statements are based on beliefs of Company management, as well as assumptions and estimates based on information currently available to the Company, 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: general economic conditions; ability to acquire inventory at favorable prices; integration of acquisitions; marketplace competition; economic and aviation/aerospace market stability and Company profitability. Should one or more of these risks or uncertainties materialize adversely, or should underlying assumptions or estimates prove incorrect, actual results may vary materially from those described. These events and uncertainties are difficult or impossible to predict accurately and many are beyond the Company's control. The Company assumes no obligation to publicly release the result of any revisions that may be made to 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.

Quantitative and Qualitative Disclosures about Market Risk

The Company's exposure to market risk is limited to fluctuating interest rates under its unsecured bank credit agreements and foreign exchange rates. During fiscal 2001 and 2000, the Company did not utilize derivative financial instruments to offset these risks.

At May 31, 2001, $125,000 ($100,000 available through February 9, 2003 and $25,000 available through April 10, 2002) was available under credit lines with domestic banks under revolving credit and term loan agreements, and $2,700 was available under credit agreements with foreign banks (credit facilities). Interest on amounts borrowed under the credit facilities is LIBOR based. As of May 31, 2001, the outstanding balance under these agreements was $0. A hypothetical 10 percent increase to the average interest rate under the credit facilities applied to the average outstanding balance during fiscal 2001 would have reduced the Company's pre-tax income by approximately $482 during fiscal 2001.

Revenues and expenses of the Company's foreign operations in The Netherlands 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 income (loss). A hypothetical 10 percent devaluation of foreign currencies against the U.S. dollar would not have a material impact on the financial position or results of operations of the Company.

Financial Statistics

(in thousands, except per share data, ratios and employees)

For the year ended May 31,	2001	2000	1999	1998	1997
Operating Performance					
Sales	**$853,659**	$ 957,525	$ 918,036	$782,123	$589,328
Pass through sales (a)	**20,596**	66,808	132,572	74,514	44,225
Total sales	**874,255**	1,024,333	1,050,608	856,637	633,553
Gross profit	**136,467**	172,853	173,259	148,406	108,541
Operating income	**40,390**	70,658	77,381	64,716	42,890
Interest expense	**21,887**	23,431	18,567	14,494	10,786
Income before provision for income taxes	**20,220**	49,526	59,786	51,157	32,975
Net income	**18,531**	35,163	41,671	35,657	23,025
Financial Position					
Working capital	**$360,464**	$ 347,451	$ 334,600	$319,252	$314,119
Total assets	**701,854**	737,977	723,018	667,039	526,735
Short-term debt	**13,652**	26,314	420	237	1,474
Long-term debt	**179,987**	180,447	180,939	177,509 (d)	116,818
Total debt	**193,639**	206,761	181,359	177,746 (d)	118,292
Stockholders' equity	**340,212**	336,494	322,423	297,330	266,410
Number of shares outstanding at end of year (b)	**26,937**	26,865	27,381	27,717	27,306
Book value per share of common stock (b)	**$ 12.63**	$ 12.53	$ 11.78	$ 10.73	$ 9.76
Ratio Analysis					
Current ratio	**3.9:1**	3.1:1	2.9:1	3.1:1	4.1:1
Return on sales (c)	**2.2%**	3.7%	4.5%	4.6%	3.9%
Gross profit margin (c)	**16.0%**	18.1%	18.9%	19.0%	18.4%
Return on average invested capital	**6.7%**	9.4%	11.0%	10.5%	8.6%
Return on average equity	**5.5%**	10.6%	13.4%	12.7%	10.0%
Ratio of long-term debt to capitalization	**34.6%**	34.9%	35.9%	37.4% (d)	30.5%
Ratio of total debt to capitalization	**36.3%**	38.1%	36.0%	37.4% (d)	30.7%
Sales per employee (c)	**$ 319**	$ 331	$ 323	$ 318	$ 271
Share Data (b)					
Earnings per share—basic	**$ .69**	$ 1.30	$ 1.51	$ 1.29	$ .92
Earnings per share—diluted	**$ .69**	$ 1.28	$ 1.49	$ 1.27	$ .91
Cash dividends per share	**$ .34**	$ .34	$ .34	$ .33	$ .32
Average common shares outstanding—basic	**26,913**	27,103	27,549	27,588	25,026
Average common shares outstanding—diluted	**26,985**	27,415	28,006	28,174	25,399
Number of Employees	**2,500**	2,900	2,900	2,700	2,100

(a) In connection with certain long-term inventory management programs, the Company purchases factory-new products on behalf of its customers from original equipment manufacturers. These products are purchased from the manufacturer and "passed through" to the Company's customers at the Company's cost.

(b) All share and per share information reflects the three-for-two stock split on February 23, 1998.

(c) Ratios are calculated on sales before pass through sales.

(d) In December 1997, the Company sold $60,000 of unsecured 6.875% Notes due December 15, 2007.

Quarterly Results of Operations

(dollars in thousands, except per share amounts)

Fiscal 2001

Quarter	Sales	Gross Profit	Net Income	Diluted Earnings Per Share
First	**$ 241,770**	**$ 34,415**	**$ 3,159**	**$ .12**
Second	**211,335**	**35,337**	**4,278**	**.16**
Third	**200,071**	**35,746**	**5,388**	**.20**
Fourth	**221,079**	**30,969**	**5,706**	**.21**
	$ 874,255	**$136,467**	**$18,531**	**$ .69**

Fiscal 2000

Quarter	Sales	Gross Profit	Net Income	Diluted Earnings Per Share
First	$ 266,683	$ 44,190	$ 10,831	$ .39
Second	260,240	45,728	10,906	.40
Third	272,331	45,074	10,955	.40
Fourth	225,079	37,861	2,471	.09
	$1,024,333	$ 172,853	$ 35,163	$1.28

Market Prices and Dividends

Per Common Share	Fiscal 2001			Fiscal 2000		
	Market Prices		Quarterly	Market Prices		Quarterly
Quarter	High	Low	Dividends	High	Low	Dividends
First	**$15.1875**	**$10.3125**	**$ .085**	$23.2500	$18.3750	$ .085
Second	**13.5625**	**10.0000**	**.085**	21.9375	15.9375	.085
Third	**15.1900**	**10.3125**	**.085**	26.8750	15.8125	.085
Fourth	**15.2500**	**10.9500**	**.085**	23.6250	13.8750	.085
			$ .340			$ .340

Consolidated Statements of Income

(in thousands except per share data)

For the year ended May 31,	2001	2000	1999
Sales:			
Sales from products and leasing	**$753,104**	$ 859,214	$ 828,142
Sales from services	**100,555**	98,311	89,894
Pass through sales	**20,596**	66,808	132,572
	874,255	1,024,333	1,050,608
Costs and operating expenses:			
Cost of products and leasing	**636,349**	706,042	672,625
Cost of services	**80,843**	78,630	72,152
Cost of pass through sales	**20,596**	66,808	132,572
Selling, general and administrative and other	**96,077**	102,195	95,878
	833,865	953,675	973,227
Operating income	**40,390**	70,658	77,381
Interest expense	**(21,887)**	(23,431)	(18,567)
Interest income	**1,717**	2,299	972
Income before provision for income taxes	**20,220**	49,526	59,786
Provision for income taxes	**1,689**	14,363	18,115
Net income	**$ 18,531**	$ 35,163	$ 41,671
Earnings per share of common stock—basic	**$ .69**	$ 1.30	$ 1.51
Earnings per share of common stock—diluted	**$ .69**	$ 1.28	$ 1.49

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

Consolidated Balance Sheets

(in thousands)

Assets	May 31, 2001	May 31, 2000
Current assets:		
Cash and cash equivalents	**$ 13,809**	$ 1,241
Accounts receivable	**115,187**	128,348
Inventories	**263,099**	275,817
Equipment on or available for short-term leases	**57,491**	60,201
Deferred tax assets, deposits and other	**36,270**	45,660
Total current assets	**485,856**	511,267
Property, plant and equipment, at cost:		
Land	**6,893**	6,331
Buildings and improvements	**70,258**	68,387
Equipment, furniture and fixtures	**125,234**	127,879
	202,385	202,597
Accumulated depreciation	**(93,478)**	(92,594)
	108,907	110,003
Other assets:		
Investment in leveraged leases	**28,715**	34,487
Cost in excess of underlying net assets of acquired companies, net	**45,375**	38,840
Other	**33,001**	43,380
	107,091	116,707
	$701,854	$737,977

Liabilities and Stockholders' Equity	May 31, 2001	May 31, 2000
Current liabilities:		
Short-term debt	**$ –**	$ 25,885
Current maturities of long-term debt	**410**	429
Notes payable	**13,242**	–
Accounts and trade notes payable	**73,975**	107,879
Accrued liabilities	**35,706**	26,596
Accrued taxes on income	**2,059**	3,027
Total current liabilities	**125,392**	163,816
Long-term debt, less current maturities	**179,987**	180,447
Deferred tax liabilities	**55,063**	56,020
Retirement benefit obligation	**1,200**	1,200
	236,250	237,667
Stockholders' equity:		
Preferred stock, $1.00 par value, authorized 250 shares; none issued	**–**	–
Common stock, $1.00 par value, authorized 100,000 shares; issued 29,371 and 29,168 shares, respectively	**29,371**	29,168
Capital surplus	**148,316**	146,557
Retained earnings	**219,848**	210,474
Treasury stock, 2,434 and 2,303 shares at cost, respectively	**(39,041)**	(37,236)
Unearned restricted stock awards	**(2,499)**	(3,021)
Accumulated other comprehensive income (loss):		
Cumulative translation adjustments	**(12,731)**	(9,448)
Minimum pension liability	**(3,052)**	–
	340,212	336,494
	$701,854	$737,977

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

Consolidated Statements of Stockholders' Equity

(in thousands)

For the three years ended May 31, 2001	Common Stock Shares	Common Stock Amount	Treasury Stock Shares	Treasury Stock Amount	Capital Surplus	Retained Earnings	Unearned Restricted Stock Awards	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income (Loss)
Balance, May 31, 1998	28,832	$28,832	1,128	$ (16,470)	$ 140,898	$ 152,233	$ (3,520)	$ (4,643)	
Net income	–	–	–	–	–	41,671	–	–	$41,671
Cash dividends	–	–	–	–	–	(9,375)	–	–	
Treasury stock	–	–	489	(8,993)	–	–	–	–	
Exercise of stock options and stock awards	166	166	–	–	3,197	–	–	–	
Restricted stock activity	–	–	–	–	–	–	(92)	–	
Adjustment for net translation loss	–	–	–	–	–	–	–	(1,481)	(1,481)
Comprehensive income for fiscal 1999									$40,190
Balance, May 31, 1999	28,998	$28,998	1,617	$ (25,463)	$ 144,095	$ 184,529	$ (3,612)	$ (6,124)	
Net income	–	–	–	–	–	35,163	–	–	$35,163
Cash dividends	–	–	–	–	–	(9,218)	–	–	
Treasury stock	–	–	686	(11,773)	–	–	–	–	
Exercise of stock options and stock awards	170	170	–	–	2,462	–	–	–	
Restricted stock activity	–	–	–	–	–	–	591	–	
Adjustment for net translation loss	–	–	–	–	–	–	–	(3,324)	(3,324)
Comprehensive income for fiscal 2000									$31,839
Balance, May 31, 2000	29,168	$29,168	2,303	$ (37,236)	$ 146,557	$ 210,474	$ (3,021)	$ (9,448)	
Net income	–	–	–	–	–	18,531	–	–	$18,531
Cash dividends	–	–	–	–	–	(9,157)	–	–	
Treasury stock	–	–	131	(1,805)	–	–	–	–	
Exercise of stock options and stock awards	203	203	–	–	1,759	–	–	–	
Restricted stock activity	–	–	–	–	–	–	522	–	
Adjustment for net translation loss	–	–	–	–	–	–	–	(3,283)	(3,283)
Minimum pension liability	–	–	–	–	–	–	–	(3,052)	(3,052)
Comprehensive income for fiscal 2001									$12,196
Balance, May 31, 2001	**29,371**	**$29,371**	**2,434**	**$(39,041)**	**$148,316**	**$219,848**	**$(2,499)**	**$(15,783)**	

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

Consolidated Statements of Cash Flows

(in thousands)

For the year ended May 31,	2001	2000	1999
Cash flows from operating activities:			
Net income	**$ 18,531**	$ 35,163	$ 41,671
Adjustments to reconcile net income to net cash provided from operating activities:			
Depreciation and amortization	**18,577**	18,373	17,063
Deferred taxes	**(312)**	9,570	10,970
Changes in certain assets and liabilities, excluding effects of acquired businesses:			
Accounts receivable	**20,712**	31,532	(6,991)
Inventories	**17,887**	(6,644)	(46,212)
Equipment on or available for short-term leases	**2,356**	(26,593)	3,214
Accounts and trade notes payable	**(35,034)**	(21,536)	24,659
Accrued liabilities and taxes on income	**79**	(13,786)	(3,933)
Other	**3,297**	(16,028)	(11,916)
Net cash provided from operating activities	**46,093**	10,051	28,525
Cash flows from investing activities:			
Property, plant and equipment expenditures, net	**(13,134)**	(22,344)	(36,131)
Acquisitions, less cash acquired	**(3,200)**	–	(15,175)
Proceeds from sale of business	**–**	–	11,685
Investment in equipment on long-term leases and leveraged leases	**5,446**	(434)	23,369
Cash from (investments in) joint ventures and other	**13,029**	(431)	(6,641)
Net cash provided from (used in) investing activities	**2,141**	(23,209)	(22,893)
Cash flows from financing activities:			
Proceeds (repayments) of short-term debt	**(25,885)**	25,885	–
Change in borrowings	**(479)**	(484)	2,053
Cash dividends	**(9,157)**	(9,218)	(9,375)
Purchases of treasury stock	**(211)**	(10,530)	(7,558)
Proceeds from exercise of stock options and other	**116**	376	278
Net cash provided from (used in) financing activities	**(35,616)**	6,029	(14,602)
Effect of exchange rate changes on cash	**(50)**	120	(2)
Increase (decrease) in cash and cash equivalents	**12,568**	(7,009)	(8,972)
Cash and cash equivalents, beginning of year	**1,241**	8,250	17,222
Cash and cash equivalents, end of year	**$ 13,809**	$ 1,241	$ 8,250

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

AAR CORP. (the Company) supplies a variety of products and services to the worldwide aviation/aerospace industry. Products and services are sold primarily to commercial, domestic and foreign airlines; business aircraft operators; aviation original equipment manufacturers; aircraft leasing companies; domestic and foreign military agencies and independent aviation support companies.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its subsidiaries after elimination of intercompany accounts and transactions.

Revenue Recognition

Sales and related cost of sales for product sales are recognized upon shipment of products. Service revenues and the related cost of services are generally recognized when customer-owned material is shipped. Lease revenues are recognized as earned.

In connection with certain long-term inventory management programs, the Company purchases factory-new products on behalf of its customers from original equipment manufacturers. These products are purchased from the manufacturer and "passed through" to the Company's customer at the Company's cost. During the third quarter of fiscal 2000, the SEC issued Staff Accounting Bulletin (SAB) No. 101 summarizing the SEC's view in applying generally accepted accounting principles to revenue recognition. As a result of SAB No. 101, the Company began reporting pass through sales in the consolidated income statement beginning with the third quarter of fiscal 2000. Prior to SAB No. 101, the Company believed that excluding pass through sales from sales was appropriate given the limited nature of the services provided in connection with these transactions.

New Accounting Standards

SFAS (Statement of Financial Accounting Standards) No. 133 "Accounting for Derivative Instruments and Hedging Activities" is effective for fiscal years beginning after June 15, 2000. SFAS No. 133 establishes accounting and reporting standards for derivative instruments and for certain hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. The adoption of SFAS No. 133 will not have a material impact on the Company's financial position or results of operations.

In July 2001, the Financial Accounting Standards Board issued SFAS No. 141 "Business Combinations" and SFAS No. 142 "Goodwill and Other Intangible Assets." SFAS No. 141 requires all business combinations to be accounted for using the purchase method. SFAS No. 142 eliminated the amortization of goodwill and also requires that goodwill be tested for impairment. SFAS No. 141 is effective for business combinations after June 30, 2001. SFAS No. 142 is required for fiscal years beginning after December 15, 2001. Early adoption is permitted for companies with a fiscal year beginning after March 2001, provided that the first quarter financial statements have not previously been issued. Because the Company expects to adopt these statements effective with the first quarter of fiscal 2002, the Company will not have goodwill amortization after fiscal 2001.

Cash and Cash Equivalents

The Company considers all highly liquid investments with maturities of three months or less to be cash equivalents. At May 31, 2001 and 2000, cash equivalents of approximately $139 and $122, respectively, represent investments in funds holding U.S. Government agency-issued securities. The carrying amount of cash equivalents approximates fair value at May 31, 2001 and 2000, respectively.

Transfer of Financial Assets

During fiscal 2001, the Company adopted SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," which requires the Company to recognize the financial and servicing assets it controls and the liabilities it has incurred, and to derecognize financial assets when control has been surrendered.

One of the Company's consolidated subsidiaries, a special purpose entity, has an agreement (securitization), with a major financial institution to sell an undivided interest in its accounts receivable up to $35,000. The agreement involves the sale of accounts receivable by certain of the Company's domestic subsidiaries to the special purpose entity which in turn sells the accounts receivable to the financial institution. Accounts receivable greater than 120 days past due are not eligible to be sold to the financial institution. The Company retains collection and administrative responsibilities for the accounts receivable sold.

At May 31, 2001, accounts receivable sold under the program were $30,455, and the cash proceeds from the transaction were $18,984. This resulted in a $18,984 reduction in accounts receivable on the May 31, 2001 consolidated balance sheet. At May 31, 2000, accounts receivable sold under the program were $42,218 and the cash proceeds were $29,359. This resulted in a $29,359 reduction in accounts receivable on the May 31, 2000 consolidated balance sheet. The retained undivided interest of $11,471 and $12,859 as of May 31, 2001 and 2000, respectively, are included in accounts receivable at fair value, which takes into consideration expected credit losses based on the specific identification of uncollectable accounts. Since substantially all accounts receivable sold carry 30 day payment terms, the retained interest is not discounted.

Foreign Currency

All balance sheet accounts of foreign subsidiaries transacting business in currencies other than the Company's functional currency 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 income (loss).

Financial Instruments and Concentrations of Market or Credit Risk

Financial instruments that potentially subject the Company to concentrations of market or credit risk consist principally of trade receivables. While the Company's trade receivables are diverse based on the number of entities and geographic regions, the majority are in the aviation/aerospace industry. The Company performs evaluations of customers' financial condition prior to extending credit privileges and performs ongoing credit evaluations of payment experience, current financial condition and risk analysis. The Company typically requires collateral in the form of security interest in assets, letters of credit, and/or obligation guarantees from financial institutions for transactions other than on normal trade terms.

SFAS No. 107 "Disclosures about Fair Value of Financial Instruments" requires disclosure of the fair value of certain financial instruments. Cash and cash equivalents, accounts receivable, short-term borrowings, accounts payable and accrued liabilities are reflected in the consolidated financial statements at 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 market 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. Cost is determined by either the specific identification, average cost or first-in, first-out method.

The following is a summary of inventories:

May 31,	2001	2000
Raw materials and parts	**$ 55,851**	$ 51,180
Work-in-process	**20,208**	19,121
Purchased aircraft, parts, engines and components held for sale	**187,040**	205,516
	$263,099	$275,817

During the fourth quarter fiscal 2001, the Company recorded a $5,400 provision to reduce the value of certain inventory previously used to support a major program customer to net realizable value.

Equipment under Operating Leases

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

Equipment on short-term lease consists of 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.

Property, Plant and Equipment

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. Leasehold improvements are amortized over the shorter of the estimated useful life or the term of the applicable lease.

Repairs 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.

Leveraged Leases

The Company acts as an equity participant in leveraged lease transactions. The equipment cost in excess of equity contribution is financed by third parties in the form of secured debt. Under the lease agreements, the third parties have no recourse against the Company for nonpayment of the obligations. The third-party debt is collateralized by the lessees' rental obligations and the leased equipment.

The Company has ownership rights to the leased assets and is entitled to the investment tax credits and benefits of tax deductions for depreciation on the leased assets and for interest on the secured debt financing.

Cost in Excess of Underlying Net Assets of Acquired Companies

The cost in excess of underlying net assets of acquired companies is being amortized over a period of 40 years. The increase in cost in excess of underlying net assets of acquired companies at May 31, 2001 is attributable to the acquisition of Hermetic during fiscal 2001. Amortization expense was $1,249, $1,213 and $802 in fiscal 2001, 2000 and 1999, respectively. Accumulated amortization is $7,437 and $6,188 at May 31, 2001 and 2000, respectively. See New Accounting Standards section of this note for a description of SFAS No. 142, which will result in no amortization of goodwill after fiscal 2001. The Company evaluates the existence of impairment on the basis of whether the cost in excess of underlying net assets of acquired companies is fully recoverable from projected, undiscounted net cash flows.

Income Taxes

Income taxes are determined in accordance with SFAS No. 109.

The benefits of investment tax credits are recognized for financial reporting purposes under the deferral method of accounting for leveraged leases. The investment tax credits are recognized in the year earned for income tax purposes.

Statements of Cash Flows

Supplemental information on cash flows follows:

For the year ended May 31,	2001	2000	1999
Interest paid	**$21,700**	$22,800	$18,800
Income taxes paid	**3,200**	11,300	4,400
Income tax refunds and interest received	**6,900**	500	900

Use of Estimates

Management of the Company has made estimates and 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.

Reclassification

Certain amounts in the prior years' consolidated financial statements have been reclassified to conform to the current year's presentation.

2. FINANCING ARRANGEMENTS

Short-term borrowing activity was as follows:

For the year ended May 31,	2001	2000	1999
Maximum amount borrowed	**$110,500**	$127,600	$92,300
Average daily borrowings	**71,917**	94,881	45,455
Average interest rate during the year	**6.7%**	5.9%	5.4%

At May 31, 2001, aggregate unsecured bank credit arrangements were $127,700. Of this amount, $125,000 was available under revolving credit and term loan agreements with domestic banks and $2,700 was available under credit agreements with foreign banks. There are no compensating balance requirements in connection with domestic or foreign lines of credit.

The Company may borrow a maximum of $125,000 ($100,000 available through February 9, 2003 and $25,000 available through April 10, 2002) under revolving credit and term loan agreements with domestic banks. Certain revolving credit borrowings may, at the Company's option, be converted to term loans payable in equal quarterly installments over five years. Interest on amounts borrowed under the credit facilities is LIBOR based. Borrowings outstanding under these agreements at May 31, 2001 were $0. There are no compensating balance requirements on any of the committed lines, but the Company is required to pay a commitment fee. There are no restrictions on the withdrawal or use of these funds.

Long-term debt was as follows:

May 31,	2001	2000
Notes payable due November 1, 2001 with interest of 9.5% payable semi-annually on May 1 and November 1	**$ 65,000**	$ 65,000
Notes payable due October 15, 2003 with interest of 7.25% payable semi-annually on April 15 and October 15	**50,000**	50,000
Notes payable due December 15, 2007 with interest of 6.875% payable semi-annually on June 15 and December 15	**60,000**	60,000
Other, primarily industrial revenue bonds (secured by trust indentures on property, plant and equipment) with weighted average interest of approximately 3.25% to 6.5% at May 31, 2001	**5,397**	5,876
	180,397	180,876
Current maturities	**(410)**	(429)
	$179,987	$180,447

The Company is subject to a number of covenants under the revolving credit and term loan agreements, including restrictions which 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 the Company's shares and other matters. The Company is in compliance with all restrictive financial provisions of the agreements. At May 31, 2001, unrestricted consolidated retained earnings available for payment of dividends and purchase of the Company's shares was approximately $27,783. Effective June 1, 2001, unrestricted consolidated retained earnings increased to $37,049 due to inclusion of 50% of the consolidated net income of the Company for fiscal 2001. The aggregate amount of long-term debt maturing during each of the next five fiscal years is $65,410 in 2002, $394 in 2003, $51,406 in 2004, $284 in 2005 and $289 in 2006. The Company's long-term debt was estimated to have a fair value of approximately $180,285 at May 31, 2001 and was based on estimates using discounted future cash flows at an assumed rate for borrowings currently prevailing in the marketplace for similar instruments.

On June 7, 2001, the Company completed a $75,000 private placement of long-term debt, including $55,000 of ten-year notes at 8.39% due May 15, 2011 and $20,000 of seven-year notes at 7.98% due May 15, 2008.

3. INCOME TAXES

The provision for income taxes included the following components:

For the year ended May 31,	2001	2000	1999
Current			
Federal	**$ 1,580**	$ 4,070	$ 6,045
State	**421**	723	1,100
	2,001	4,793	7,145
Deferred	**(312)**	9,570	10,970
	$ 1,689	$14,363	$18,115

The deferred tax provisions (benefits) result primarily from differences between financial reporting and tax income arising from depreciation and leveraged leases.

Deferred tax liabilities and assets result primarily from the differences in the timing of the recognition for transactions between financial reporting and income tax purposes and consist of the following components:

May 31,	2001	2000
Deferred tax liabilities attributable to:		
Depreciation	**$34,863**	$28,710
Leveraged leases	**21,200**	27,120
Other	**630**	630
Total deferred tax liabilities	**$56,693**	$56,460
Deferred tax assets—current attributable to:		
Inventory costs	**$ 4,810**	$ 3,160
Employee benefits	**100**	2,980
Alternative minimum tax	**3,100**	1,090
Other	**5**	240
Total deferred tax assets—current	**$ 8,015**	$ 7,470
Deferred tax assets—noncurrent attributable to:		
Postretirement benefits	**$ 1,630**	$ 440
Total deferred tax assets—noncurrent	**$ 1,630**	$ 440
Total deferred tax assets	**$ 9,645**	$ 7,910
Net deferred tax liabilities	**$47,048**	$48,550

The Company has determined that the realization of deferred tax assets is more likely than not, and that a valuation allowance is not required based upon the Company's history of prior operating earnings, its expectations for continued future earnings and the scheduled reversal of deferred tax liabilities, primarily related to leveraged leases, which exceed the amount of the deferred tax assets.

The provision for income taxes differs from the amount computed by applying the U.S. Federal statutory income tax rate of 35% for fiscal 2001, 2000 and 1999, for the following reasons:

For the year ended May 31,	2001	2000	1999
Provision for income taxes at the Federal statutory rate	**$ 7,080**	$17,330	$20,925
Tax benefits on exempt earnings from export sales	**(2,700)**	(3,815)	(3,690)
State income taxes, net of Federal benefit and refunds	**670**	900	900
Non-deductible portion of goodwill amortization	**300**	298	280
Reduction in income tax liabilities	**(3,300)**	–	–
Other, net	**(361)**	(350)	(300)
Provision for income taxes as reported	**$ 1,689**	$14,363	$18,115
Effective income tax rate	**8.4%**	29.0%	30.3%

The fiscal 2001 provision for income taxes includes a reduction in income tax expense of $3,300. This adjustment represents the reversal of Federal and state income tax liabilities for years prior to fiscal 1998, now closed to assessments.

4. COMMON STOCK AND STOCK OPTION PLANS

The Company has established stock option plans for officers and key employees of the Company. Stock option awards typically expire ten years from the date of grant or earlier upon termination of employment, become exercisable in five equal increments on successive grant anniversary dates at the New York Stock Exchange closing stock price on the date of grant and are accompanied by reload features and, for certain individuals, stock rights exercisable in the event of a change in control of the Company.

The Company accounts for these plans under Accounting Principles Board Opinion No. 25, under which no compensation cost has been recognized. Pro forma information regarding net income and earnings per share is required by SFAS No. 123 and has been determined as if the Company had accounted for its employee stock options under the fair value method of SFAS No. 123. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

The following table provides additional information regarding options (in thousands) outstanding as of May 31, 2001:

Option Exercise Price Range	Options Outstanding	Weighted Average Remaining Contractual Life of Options (Years)	Number of Options Exercisable	Weighted Average Exercise Price of Options Exercisable
$ 6.13–12.25	843	6.7	503	$10.25
$12.26–18.38	1,763	6.7	877	15.53
$18.39–24.50	1,382	6.9	901	23.20
$24.51–30.63	80	3.9	74	27.27
	4,068	6.7	2,355	$17.70

Stock Options Granted in Fiscal Year	2001	2000	1999
Risk-free interest rate	**4.93%**	6.57%	5.74%
Expected volatility of common stock	**44.8%**	38.7%	31.6%
Dividend yield	**1.8%**	1.6%	1.8%
Expected option term in years	**4.0**	4.0	4.0

The fair value weighted average per share of stock options granted during fiscal 2001, 2000 and 1999 was $4.43, $7.81 and $5.20, respectively. Had compensation cost for stock options awarded under the plans been determined in accordance with SFAS No. 123, the Company's net income and earnings per share would have been changed to the following pro forma amounts:

For the year ended May 31,	2001	2000	1999
Net income:			
As reported	**$18,531**	$35,163	$41,671
Pro forma	**16,001**	33,097	40,403
Earnings per share—basic:			
As reported	**$ .69**	$ 1.30	$ 1.51
Pro forma	**$ .59**	$ 1.22	$ 1.47
Earnings per share—diluted:			
As reported	**$ .69**	$ 1.28	$ 1.49
Pro forma	**$ .59**	$ 1.21	$ 1.44

A summary of changes in stock options (in thousands) granted to officers, key employees and nonemployee directors under stock option plans for the three years ended May 31, 2001 follows:

	Number of Shares	Weighted Average Exercise Price
Outstanding, May 31, 1998		
(785 exercisable)	2,484	$16.54
Granted	827	19.41
Exercised	(71)	11.95
Surrendered/expired/cancelled	(64)	18.53
Outstanding, May 31, 1999		
(1,148 exercisable)	3,176	17.36
Granted	519	22.48
Exercised	(105)	12.40
Surrendered/expired/cancelled	(164)	20.05
Outstanding, May 31, 2000		
(1,508 exercisable)	3,426	18.16
Granted	946	12.32
Exercised	(140)	8.83
Surrendered/expired/cancelled	(164)	18.36
Outstanding, May 31, 2001		
(2,355 exercisable)	**4,068**	**$16.79**

The AAR CORP. Stock Benefit Plan also provides for the grant of restricted stock awards. Restrictions are released at the end of applicable restricted periods. The number of shares and the restricted period, which varies from three to ten years, are determined by the Compensation Committee of the Board of Directors. At the date of grant, the market value of the award (based on the New York Stock Exchange closing price) is recorded in common stock and capital surplus; an offsetting amount is recorded as a component of stockholders' equity in unearned restricted stock awards. Compensation cost is included in results of operations over the vesting period. The expense relating to outstanding restricted stock awards was $1,055, $1,354 and $1,667 in fiscal 2001, 2000 and 1999, respectively.

The AAR CORP. Employee Stock Purchase Plan is open to employees of the Company (other than officers, directors or participants in other stock option plans of the Company) and permits employees to purchase common stock in periodic offerings through payroll deductions.

The numbers of options and awards outstanding and available for grant or issuance for each of the Company's stock plans are as follows:

May 31, 2001	Outstanding	Available	Total
Stock Benefit Plan (officers, directors and key employees)	4,364	1,069	5,433
Employee Stock Purchase Plan	–	144	144

Pursuant to a shareholder rights plan adopted in 1997, each outstanding share of the Company's common stock carries with it a Right to purchase one and one half additional shares at a price of $83.33 per share (adjusted to reflect the February 23, 1998 stock split and subject to further antidilution adjustments). 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 the Company is 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 $83.33 per share (or the then-current exercise price), shares of the Company's common stock having a market value of $166.66 (or two times the exercise price), subject to certain exceptions. Similarly, if the Company is acquired in a merger or other business combination or 50% or more of its 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, 2007, and may be redeemed by the Company for $.01 per Right under certain circumstances.

On September 21, 1990, the Board of Directors authorized the Company to purchase up to 1,500 shares (adjusted for the three-for-two stock split) of the Company's common stock on the open market or through privately negotiated transactions. On October 13, 1999, the Board of Directors authorized the Company to purchase up to 1,500 additional shares of the Company's common stock. As of May 31, 2001, the Company had purchased 1,720 shares of its common stock on the open market under these programs at an average price of $14.09 per share.

5. EARNINGS PER SHARE

The computation of basic earnings per share is based on the weighted average number of common shares outstanding during the year. Diluted earnings per share is based on the weighted average number of common shares outstanding during the year plus, when their effect is dilutive, potentially issuable common stock consisting of shares subject to stock options. The following table provides a reconciliation of the computations of basic and diluted earnings per share information for each of the years in the three-year period ended May 31, 2001.

For the year ended May 31,	2001	2000	1999
Basic EPS:			
Net income	**$18,531**	$35,163	$41,671
Average common shares outstanding	**26,913**	27,103	27,549
Earnings per share—basic	**$ .69**	$ 1.30	$ 1.51
Diluted EPS:			
Net income	**$18,531**	$35,163	$41,671
Average common shares outstanding	**26,913**	27,103	27,549
Additional shares due to hypothetical exercise of stock options	**72**	312	457
Average common shares outstanding—diluted	**26,985**	27,415	28,006
Earnings per share—diluted	**$ .69**	$ 1.28	$ 1.49

6. EMPLOYEE BENEFIT PLANS

The Company has defined contribution or defined benefit plans covering substantially all full-time domestic employees and certain employees in The Netherlands.

Defined Benefit Plans

Prior to January 1, 2000, the pension plan for domestic salaried employees had benefit formulas primarily based on years of service and compensation. Effective January 1, 2000, the Company converted its existing defined benefit plan for substantially all domestic salaried employees to a cash balance pension plan. Under the cash balance pension plan, the retirement benefit is expressed as a dollar amount in an account that grows with annual pay-based credits and interest on the account balance. The pension benefit for hourly employees is generally based on a fixed amount per year of service. The Company follows the provisions of SFAS No. 87 "Employers' Accounting for Pensions" and SFAS No. 132 "Employer's Disclosures about Pension and Other Postretirement Benefits" for all pension and postretirement plans.

The Company's funding policy for domestic plans is to contribute annually, at a minimum, an amount which is deductible for Federal income tax purposes and that is sufficient to meet actuarially computed pension benefits. Contributions are intended to provide for benefits attributed to service to date and for benefits expected to be earned in the future. The assets of the pension plans are invested primarily in mutual funds, common stocks, investment grade bonds and U.S. Government obligations.

Certain foreign operations of domestic subsidiaries also have pension plans. In most cases, the plans are defined benefit in nature. Assets of the plans are comprised of insurance contracts. Benefit formulas are based generally on years of service and compensation. It is the policy of these subsidiaries to fund at least the minimum amounts required by local law and regulation.

The Company provides its outside directors with benefits upon retirement on or after age 65 provided they have completed at least five years of service as a director. Benefits are paid quarterly in cash in an amount equal to 25.0% of the annual retainer fee payable by the Company to active outside directors. Payment of benefits commences upon retirement and continues for a period equal to the total number of years of the retired director's service as a director to a maximum of ten years, or death, whichever occurs first. In the fourth quarter of fiscal 2001, the Company terminated this plan for any new members of the Board of Directors elected after May 31, 2001.

The Company also provides supplemental retirement and profit sharing benefits for current and former executives and key employees to supplement benefits provided by the Company's other benefit plans. The plans are not fully funded and may require funding in the event of a change in control of the Company as determined by the Company's Board of Directors.

The following table sets forth the plans' funded status, including the change in plan assets, and the amount recognized in the Company's Consolidated Balance Sheets.

May 31,	2001	2000
Change in benefit obligation:		
Benefit obligation at beginning of year	**$ 59,268**	$ 52,516
Service cost	**2,867**	2,785
Interest cost	**4,411**	4,035
Plan participants' contributions	**218**	220
Amendments	**887**	3,564
Net actuarial (gain) loss	**1,011**	(1,874)
Benefits paid	**(3,827)**	(1,978)
Benefit obligation at end of year	**$ 64,835**	$ 59,268
Change in plan assets:		
Fair value of plan assets at beginning of year	**$ 46,349**	$ 44,096
Actual return on plan assets	**391**	2,369
Employer contributions	**5,918**	1,642
Plan participants' contributions	**218**	220
Benefits paid	**(3,827)**	(1,978)
Fair value of plan assets at end of year	**$ 49,049**	$ 46,349
Funded status	**$(15,786)**	$(12,919)
Unrecognized actuarial losses	**10,745**	5,916
Unrecognized prior service cost	**5,292**	4,890
Unrecognized transitional obligation	**325**	418
Prepaid pension costs	**$ 576**	$ (1,695)

The projected benefit obligation for domestic plans is determined using an assumed weighted average discount rate of 7.75% at May 31, 2001 and 8.25% at May 31, 2000, and an assumed average compensation increase of 4.5%. The expected long-term rate of return on assets is 10.0% for fiscal 2001 and 2000. The unrecognized actuarial losses, prior service cost and transition obligation are amortized on a straight-line basis over the estimated average future service period.

The projected benefit obligation for nondomestic plans is determined using an assumed weighted average discount rate of 6.0% at May 31, 2001 and 6.5% at May 31, 2000, and an assumed average compensation increase of 4.0%. The expected long-term rate of return on assets is 6.5% for fiscal 2001 and 2000.

Pension expense charged to results of operations includes the following components:

For the year ended May 31,	2001	2000	1999
Service cost	**$ 2,867**	$ 2,785	$ 2,426
Interest cost	**4,411**	4,035	3,476
Expected return on plan assets	**(4,275)**	(3,881)	(3,560)
Amortization of prior service cost	**485**	266	235
Recognized net actuarial loss	**24**	460	398
Transitional obligation	**89**	91	92
	$ 3,601	$ 3,756	$ 3,067

Defined Contribution Plan

The defined contribution plan is a profit sharing plan which is intended to qualify as a 401(k) plan under the Internal Revenue Code. Under the plan, employees may contribute up to 15.0% of their pretax compensation, subject to applicable regulatory limits. The Company may make matching contributions up to 6.0% of compensation. Participants vest on a pro-rata basis in Company contributions during the first three years of employment. Expense charged to results of operations was $1,550, $1,634 and $1,491 in fiscal 2001, 2000 and 1999, respectively.

Postretirement Benefits Other Than Pensions

The Company provides health and life insurance benefits for certain eligible employees and retirees under a variety of plans. Generally these benefits are contributory with retiree contributions adjusted annually. The postretirement plans are unfunded, and the Company has the right to modify or terminate any of these plans in the future, in certain cases, subject to union bargaining agreements. In fiscal 1995, the Company completed termination of postretirement healthcare and life insurance benefits attributable to future services of collective bargaining and other domestic employees.

Postretirement benefit cost for the years ended May 31, 2001, 2000 and 1999 included the following components:

For the year ended May 31,	2001	2000	1999
Service cost	**$ –**	$ –	$ –
Interest cost	**105**	104	96
Amortization of prior service cost	**16**	16	16
	$121	$120	$112

The funded status of the plans at May 31, 2001 and 2000 was as follows:

May 31,	2001	2000
Change in benefit obligations:		
Benefit obligations at beginning of year	**$ 1,357**	$ 1,463
Interest cost	**105**	104
Benefits paid	**(170)**	(153)
Unrecognized actuarial (gain) loss	**45**	(57)
Plan participants' contributions	**–**	–
Benefit obligation at end of year	**$ 1,337**	$ 1,357
Change in plan assets:		
Fair value of plan assets at beginning of year	**$ –**	$ –
Company contributions	**170**	153
Benefits paid	**(170)**	(153)
Plan participants' contributions	**–**	–
Fair value of plan assets at end of year	**$ –**	$ –
Funded status	**$(1,337)**	$(1,357)
Unrecognized actuarial gains	**(7)**	(3)
Unrecognized prior service cost	**144**	160
Accrued postretirement costs	**$(1,200)**	$(1,200)

The assumed discount rate used to measure the accumulated postretirement benefit obligation was 7.75% at May 31, 2001 and 8.25% at May 31, 2000. The assumed rate of future increases in healthcare costs was 6.8% and 7.5% in fiscal 2001 and 2000, respectively, declining to 5.25% by the year 2004 and remaining at that rate thereafter. A one percent increase in the assumed healthcare cost trend rate would increase the accumulated postretirement benefit obligation by approximately $49 as of May 31, 2001 and would not result in a significant change to the annual postretirement benefit expense.

7. COMMITMENTS AND CONTINGENCIES

The Company leases certain facilities and equipment under agreements which are accounted for as operating leases that expire at various dates through 2011. The Company also leases certain aviation equipment which are accounted for as operating leases. The terms of these arrangements are one to five years with options to renew annually at the election of the Company. If the Company elects to not renew a lease, the Company is required to purchase the aviation equipment at its stipulated lease value. The Company may also sublease the aviation equipment to a customer on a short- or long-term basis. Future minimum payments and sublease income under leases with initial or remaining terms of one year or more at May 31, 2001 are as follows:

Future Minimum Payments

Year	Facilities and Equipment	Aviation Equipment	Sublease Income
2002	$5,020	$2,319	$2,220
2003	3,919	2,319	2,220
2004	3,307	2,319	2,220
2005	2,719	1,159	2,220
2006 and thereafter	1,255	18,146	2,035

Rental expense during the past three fiscal years was as follows:

For the year ended May 31,	2001	2000	1999
Facilities and Equipment	**$ 8,484**	$9,663	$8,339
Aviation Equipment	**10,199**	8,344	4,242

The Company routinely issues letters of credit, performance bonds or credit guarantees in the ordinary course of its business. These instruments are typically issued in conjunction with insurance contracts or other business requirements. The total of these instruments outstanding at May 31, 2001 was approximately $27,600.

The Company is involved in various claims and legal actions, including environmental matters, arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company's consolidated financial condition or results of operations.

8. INVESTMENT IN LEVERAGED LEASES

From time to time, the Company acquires aircraft under leases that qualify for leveraged lease accounting treatment. Typically, these are long-term leases of late-model aircraft operated by major carriers where the Company is an equity participant of at least 20% and there is a third-party provider of nonrecourse debt of the remaining equipment cost.

During the lease term the Company is required, in accordance with SFAS No. 13, to adjust the elements of the investment in leveraged leases to reflect changes in important economic assumptions, such as the renegotiation of the interest rate on the nonrecourse debt or changes in income tax rates. The Company's net investment in leveraged leases is comprised of the following elements:

May 31,	2001	2000
Rentals receivable (net of principal and interest on the nonrecourse debt)	**$ 13,415**	$ 15,488
Estimated residual value of leased assets	**26,615**	32,952
Unearned and deferred income	**(11,315)**	(13,953)
	28,715	34,487
Deferred taxes	**(21,200)**	(27,120)
Net investment in leveraged leases	**$ 7,515**	$ 7,367

Pretax income from leveraged leases was $2,640, $695 and $702 in fiscal 2001, 2000 and 1999, respectively.

9. OTHER NONCURRENT ASSETS

At May 31, 2001 and 2000, other noncurrent assets consisted of the following:

May 31,	2001	2000
Investment in joint ventures	**$ 3,784**	$22,811
Notes receivable	**6,353**	7,822
Cash surrender value of life insurance	**3,538**	2,719
Debt issuance costs	**609**	818
Other	**18,717**	9,210
	$33,001	$43,380

10. ACQUISITIONS

On September 29, 2000, the Company acquired substantially all the assets and assumed certain liabilities of Hermetic, an aircraft component support company providing repair and distribution services to the North American aftermarket primarily on behalf of European aircraft component manufacturers. The purchase price of $16,442 was paid with a cash payment of $3,200 and a note of $13,242 that was due and paid on June 1, 2001. The transaction was recorded under the purchase method of accounting. The Company has included in its consolidated financial statements the results of Hermetic since the date of acquisition.

On October 19, 1998, the Company acquired substantially all of the assets and assumed certain liabilities of Tempco Hydraulics Inc. (Tempco), a regional aircraft landing gear repair and overhaul business. The purchase price was approximately $7,500. The transaction was recorded under the purchase method of accounting. The Company has included in its consolidated financial statements the results of operations of Tempco since the date of acquisition.

Had the acquisitions occurred as of the beginning of the respective years, the Company's results of operations would not have been materially different.

11. BUSINESS SEGMENT INFORMATION

Segment Reporting

The Company is a leading provider of value-added products and services to the global aviation/aerospace industry. The Company's three reportable segments include Aircraft and Engines, Airframe and Accessories and Manufacturing.

Revenues in the Aircraft and Engines segment are derived from the sale and lease of used commercial aircraft and from the sale and lease of a wide variety of new, overhauled and repaired commercial aircraft engines and engine products, including spare engines and engine parts and accessories. Revenues in the Aircraft and Engines segment are also derived from the overhaul and repair of a wide range of commercial aircraft engine parts and components, as well as the overhaul and supply of parts to industrial gas and steam turbine operators.

Revenues in the Airframe and Accessories segment are derived from the sale and lease of new, overhauled and repaired airframe parts and accessories and from the overhaul and repair of a wide variety of airframe and accessory parts and components.

Revenues in the Manufacturing segment are derived from the manufacture and sale of in-plane cargo loading and handling systems, advanced composite materials, and a wide array of containers, pallets and shelters.

The accounting policies of the reportable segments are the same as those described in Note 1. The chief decision making officer of the Company evaluates performance based on the reportable segments. The expenses and assets related to corporate activities are not allocated to the reportable segments.

Selected financial information for each reportable segment is as follows:

For the year ended May 31,	2001	2000	1999
Net Sales, including pass through sales:			
Aircraft and Engines	**$357,788**	$ 507,093	$ 548,671

Airframe and Accessories	**419,313**	397,307	376,356
Manufacturing	**97,154**	119,933	125,581
	$874,255	$1,024,333	$1,050,608

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For the year ended May 31,	2001	2000	1999
Gross Profit:			
Aircraft and Engines	**$ 51,297**	$ 84,586	$ 91,335
Airframe and Accessories	**72,497**	69,607	63,833
Manufacturing	**12,673**	18,660	18,091
	$136,467	$172,853	$173,259

May 31,	2001	2000	1999
Total Assets:			
Aircraft and Engines	**$249,937**	$309,215	$308,064
Airframe and Accessories	**301,012**	291,838	264,891
Manufacturing	**84,041**	84,811	83,812
Corporate	**66,864**	52,113	66,251
	$701,854	$737,977	$723,018

For the year ended May 31,	2001	2000	1999
Capital Expenditures:			
Aircraft and Engines	**$ 1,261**	$ 2,976	$ 7,623
Airframe and Accessories	**6,488**	10,844	13,369
Manufacturing	**2,554**	2,761	6,268
Corporate	**2,831**	5,763	8,871
	$13,134	$22,344	$36,131

For the year ended May 31,	2001	2000	1999
Depreciation and Amortization:			
Aircraft and Engines	**$ 3,268**	$ 3,526	$ 2,916
Airframe and Accessories	**6,557**	6,106	5,146
Manufacturing	**4,082**	3,747	3,455
Corporate	**4,670**	4,994	5,546
	$18,577	$18,373	$17,063

Sales to the U.S. Government, its agencies and its contractors were approximately $139,072 (15.9% of total sales), $132,048 (12.9% of total sales) and $98,954 (9.4% of total sales) in fiscal 2001, 2000 and 1999, respectively. Sales to the Company's largest customer, excluding pass through sales, were $57,400 and $114,000 during fiscal 2001 and 2000, respectively. Including pass through sales, sales to the largest customer were $78,000 and $180,800 during fiscal 2001 and 2000, respectively.

Geographic Data

May 31,	2001	2000
Long-Lived Assets:		
United States	**$208,973**	$220,784
Europe	**6,953**	5,812
Other	**72**	114
	$215,998	$226,710

Export sales from the Company's U.S. operations to unaffiliated customers, the majority of which are located in Europe, the Middle East, Canada, Mexico, South America and Asia (including sales through foreign sales offices of domestic subsidiaries), were approximately $213,864 (24.5% of total sales), $184,718 (18.0% of total sales) and $209,712 (20.0% of total sales) in fiscal 2001, 2000 and 1999, respectively.

12. ALLOWANCE FOR DOUBTFUL ACCOUNTS

May 31,	2001	2000	1999
Balance, beginning of year	**$10,080**	$ 4,830	$ 3,157
Provision charged to operations	**2,141**	5,470	2,902
Deductions for accounts written off, net of recoveries	**(1,205)**	(220)	(1,229)
Balance, end of year	**$11,016**	$10,080	$ 4,830