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AIR.N - Q1 2026 AAR Corp Earnings Call

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PRESENTATION

Operator

Hello, and thank you for standing by. Welcome to AAR first-quarter fiscal year 2026 earnings conference call. (Operator Instructions)

I would now like to hand the conference over to management. You may begin.

Eric Pachapa - AAR Corp - VP, Controller & Chief Accounting Officer

Good afternoon, everyone, and welcome to AAR's fiscal year 2026 first-quarter earnings call. We're joined today by John Holmes, Chairman, President, and Chief Executive Officer; and Sean Gillen, Chief Financial Officer. The presentation material we are sharing today as part of this webcast can also be found under the Investor Relations section on our corporate website.

Before we begin, I'd like to remind you that the comments made during the call may include forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from the forward-looking statements. Accordingly, these statements are no guarantee of future performance. These risks and uncertainties are discussed in the company's earnings release and that Risk Factors section of the company's annual report on Form 10-K for the fiscal year ended May 31, 2025.

In providing the forward-looking statements, the company assumes no obligation to provide updates to reflect future circumstances or anticipated or unanticipated events. Certain non-GAAP financial information will be discussed during the call today. A reconciliation of these non-GAAP measures to the most GAAP measures is set forth in the company's earnings release and slides. A transcript of this conference call will be available shortly after the webcast on AAR's website.

At this time, I would like to turn the call over to AAR's Chairman, President, and CEO, John Holmes.

John Holmes - AAR Corp - Chairman of the Board, President, Chief Executive Officer

Thank you, and welcome, everyone, to our first quarter of fiscal year 2026 earnings call. This quarter was a very strong start to the year, and we are proud of the results we delivered as we continue to advance the execution of our strategic objectives. We have accompanying information on the slide that will be referenced as I talked through the details of this release.

Turning to slide 3, there are three key takeaways from our Q1 FY26 that I would like to highlight today. First, we delivered significant top-line growth with higher profitability. We are particularly proud of the 17% organic adjusted sales growth that we drove in the quarter.

Second, we continue to win and grow in new parts Distribution. This has been our fastest growing activity averaging more than 20% organic growth in each of the last four years. Our exclusive distribution model resonates with OEMs and it's helping to drive continued market share gains.

Third, our Trax software solution has continued its momentum on the back of the major win we announced with Delta Airlines in June. Additionally, we further enhanced our software capabilities with the acquisition of Aerostrat, which we completed in the quarter.

Turning now to slide 4, I will discuss our strategy execution in more detail. We're executing across our strategic objectives to drive growth through market share capture and new business, improved margins through cost efficiency and synergy realization, increase the intellectual property in our offerings through software and IP investments, and to continue our discipline portfolio management.

Starting with share gains and new business wins in the quarter. In our Parts Supply segment, we expanded a new parts distribution capabilities through our multiyear exclusive distribution agreement with AmSafe Bridport, a TransDigm company, becoming the exclusive KC-46 and C-40 platform distributor to the global defense and military aftermarket. This win once again demonstrates the strength of our new parts distribution capabilities across both the commercial and government markets.

Also in Repair & Engineering, we continue to make progress on our Oklahoma City and Miami Airframe MRO expansions. Both expansions are progressing well and will come online in calendar 2026 adding 15% capacity to our network.

Moving to cost efficiency, we are continuing the roll out of our paperless hangar solution, which drove increased throughput, leading to another quarter of sales growth out of the same hangar footprint. We have completed approximately 60% of the paperless rollout to date.

In Component Services, now that we have substantially completed the Product Support integration, our focus is to drive incremental volume through the acquired sites, which will lead to additional margin expansion.

In the quarter, we also maintained consistent cost discipline, reducing SG&A year over year.

In our software and IP enabled offerings, we continue to have success in the market with our Trax software solutions, particularly after Trax's selection by Delta validated its ability to scale in support of the world's largest airlines. We don't announce all of Trax's wins, but this quarter, we're proud to say that JetBlue, a longtime Trax customer, upgraded to eMobility and our cloud-hosting solution.

Also during the quarter, we acquired Aerostrat, a maintenance planning software provider, which immediately expands the reach of our software offerings and the enterprise resource planning system capabilities of our Trax software solution. Aerostrat brings exciting opportunities for growth with the potential for further integration and scope expansion among existing Trax customers.

We are proud that this was another quarter of both strong execution and new business capture.

And with that, I'll turn it over to Sean to discuss the results in more detail.

Sean Gillen - AAR Corp - Chief Financial Officer, Senior Vice President

Thanks, John. Looking out to slide 5. Total adjusted sales in the quarter grew 13% to \$740 million year over year. Excluding the sale of landing gear, which contributed sales of \$19 million in last year's quarter, Q1 organic sales grew up to 17%. We drove growth in each of our segments with particular strengths in Parts Supply.

Adjusted sales growth to government customers increased 21%, and adjusted organic sales to commercial customers increased 15% over the same period last year. For the quarter, total commercial sales made up 71% of total sales, while government sales made up the remaining 29%. Compared to the same quarter last year, adjusted EBITDA increased 18% to \$86.7 million and adjusted EBITDA margins increased to 11.7% from 11.3%.

Adjusted operating income increased 21% to \$71.6 million, with adjusted operating margins improving to 9.7% from 9.1%. Our focus on improving operating efficiencies and strong performance in our Parts Supply segment was a key driver of the improved margins. The combination of sales growth and margin expansion resulted in a year-over-year adjusted diluted EPS increase of 27% to \$1.08 from \$0.85 in the same quarter last year.

With that, I'll turn to the detailed results by segment starting with Parts Supply on slide 6.

Parts Supply sales grew 27% to \$318 million from the same quarter last year. We once again saw above-market growth of over 20% in our new parts Distribution activities with strong growth across both the commercial and government end markets.

In the quarter, we also saw a meaningful pickup in USM sales. First-quarter Parts Supply adjusted EBITDA of \$43.8 million was higher by 34% and adjusted EBITDA margin increased to 13.8% from 13.1% in the same quarter last year. Adjusted operating income rose 36% to \$40.9 million, and adjusted operating margin also increased from 12.1% to 12.9%.

Turning now to slide 7 for Repair & Engineering. Sales decreased 1% to \$215 million year over year, excluding the impact of the Landing Gear divestiture, organic sales growth in Repair & Engineering with 8% as demand remains strong for our MRO activities, and we continue to drive efficiency to increase throughput.

Adjusted EBITDA of \$28.1 million was 1% higher than in the same period last year, with adjusted EBITDA margin increasing to 13.1% from 12.8%. First-quarter adjusted operating income of \$24.9 million was 2% higher than the same period last year, and adjusted operating margin increased to 11.6% from 11.2%. These increases were primarily driven by continued strong efficiencies in our operations.

Going forward, we expect to continue to drive margin expansion in this segment from the realization of Product Support synergies, continued rollout of our paperless hanger initiatives, and the capacity expansions that are in process.

Looking at a slide 8. Integrated Solutions sales increased by 10% year over year to \$185 million. We saw strong growth in our government end markets as recent new wins ramped up in the quarter. Integrated Solutions adjusted EBITDA a \$14.2 million was 5% higher than the same period last year. Adjusted operating income of \$11 million was 5% higher, with the adjusted operating margin decreasing from 6.2% to 5.9%.

Turning to slide 9 of the presentation. During the quarter, our net debt leverage increased slightly from 2.72 times in the fourth quarter to 2.82 times. This increase was driven by both organic and inorganic investments we made in the quarter. We invested over \$50 million in inventory in the quarter to support future growth, particularly in our Parts Supply segment, as we saw opportunities in both new parts distribution and USM.

Additionally, we invested \$15 million in the acquisition of Aerostrat, which was signed and closed on August 12. While these investments drove a cash use in the quarter, we expect to be cash positive in Q2 and for the full fiscal year.

With that, I will turn the call back over to John.

John Holmes - AAR Corp - Chairman of the Board, President, Chief Executive Officer

Great. Thank you, Sean. Turning to slide 10, we have an update on our outlook for Q2. For the Q2, we expect sales growth of 7% to 10%, which excludes the impact of Landing Gear, which generated \$20.4 million in sales in Q2 last year. We expected adjusted operating margin of 9.6% to 10%. For the full fiscal year, given our strong start, we expect organic sales growth approaching 10% as compared to 9% we cited back in July.

In closing, I would like to highlight the strength of AAR as a business and as an investment. We are well-positioned in the most attractive segments of the growing aviation aftermarket. We have broad, unique distribution, and repair capabilities, including our Trax software solutions that are

unmatched in our industry. We have also continued to optimize our portfolio to deliver stronger growth and higher margins. Finally, we expect to continue to strengthen our offering with targeted acquisitions to accelerate our strategy.

I would like to thank our global team of employees for their dedication and hard work as well as our customers and our shareholders for your continued interest and support of the AAR.

And with that, we'll turn it over to the operator for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Ken Herbert, RBC.

Ken Herbert - RBC Capital Markets Inc - Analyst

Yeah. Hi, good afternoon, John and Sean. Maybe this first question you raised sort of the full-year expectation and now approaching 10% versus up 9% coming out of the fourth quarter. Is all just better results in the Parts Supply, or maybe you can just parse out sort of what's behind the slight uptick in the full-year expectations?

John Holmes - AAR Corp - Chairman of the Board, President, Chief Executive Officer

Yeah. I would say Parts Supply definitely is leading the way. We had a very strong quarter of a 27% organic growth in Parts Supply. We continue to be very, very pleased with our progress in the new parts distribution market. And the wins that we've got there continue to gain traction. And really, as you mentioned, Parts Supply is driving the improved outlook for the year.

Ken Herbert - RBC Capital Markets Inc - Analyst

And can you just comment on the pipeline for new distribution agreements? I mean, it sounds like OEMs continue to look to maybe find additional partners. Are you taking share to drive that growth, or is it really sort of first-time opportunities where parts are coming to the market through distribution?

John Holmes - AAR Corp - Chairman of the Board, President, Chief Executive Officer

Yeah. I would say the majority of the wins over the last several years have been our taking share. I mean, there definitely are net new contracts that come on the market. The one we announced this past quarter with AmSafe was an example of that. But the majority have been our taking share.

And again, we've got a different model of distribution that exclusive relationship only, where we have an exclusive relationship with the OEM where we don't represent competing product, and they have an exclusive relationship with us where they don't work with competing distributors for a given product or a given market. And that model is resonating.

And as we continue to win more business, more doors are open to us. And so, whereas we might not have been thought of as a leading new parts distributor two or three years ago, we're invited to participate in lot more conversations now, which is encouraging.

Ken Herbert - RBC Capital Markets Inc - Analyst

Great. Thanks, John. Nice quarter. I'll pass it back there.

Operator

Michael Leshock, KeyBanc Capital Markets.

Michael Leshock - KeyBanc Capital Markets Inc - Equity Analyst

Hey, good afternoon. Just wanted to ask on the updated guidance framework for 2026. You had called out strong growth in distribution across both commercial and government. Do you still expect to outgrow the market within distribution, maybe at a mid-teens rate, or is there any change either way relative to your outlook for distribution?

John Holmes - AAR Corp - Chairman of the Board, President, Chief Executive Officer

No, I think you've got it. We would maintain that outlook for distribution and would expect to continue to grow above market there.

Michael Leshock - KeyBanc Capital Markets Inc - Equity Analyst

Okay. And then maybe if you could talk a bit about the cross-selling opportunities you see within Repair and Engineering for component services specifically. Any way to frame how much you've had in terms of success to date with cross-selling opportunities and in any way to frame also how much more there are to come? Thank you.

John Holmes - AAR Corp - Chairman of the Board, President, Chief Executive Officer

Yeah, great question. So again, a big part of our strategy is to leverage our leadership position in the heavy maintenance world and use that to drive volume into our component repair shop that we acquired with the product support acquisition. And I would say that we are in the early innings of that strategy.

Our focus over the last year has really been on the integration and exiting our facility, our large facility in Long Island and transferring that volume to the two sites, one in Dallas and one in Wellington, Kansas. That work is now complete. We're still ramping up efficiency in the two sites that receive the work. But the focus now has shifted to executing on that cross-selling strategy. So we've got a long pipeline of opportunities.

I was just with a major carrier yesterday making a pitch myself as part of that strategy. And to date, we're having a lot of encouraging conversations, but the results are going to be more meaningful in the future. So a big pipeline, and like I said, we're in the early innings.

The only thing I would just say on that is the parts business, it's a much shorter sell cycle. Obviously, it's highly transactional. You're able to sell parts very quickly. The component repair business, these are longer-term agreements and it takes a while to get the customers to move the volume that they've been sending to other providers and reallocate it to us. But given the confidence and relationships that we have with our larger airline customers, particularly around heavy maintenance, we're confident we can secure that volume over time.

Michael Leshock - KeyBanc Capital Markets Inc - Equity Analyst

Appreciate it. Thank you.

Operator

Scott Mikus, Melius Research.

Scott Mikus - Melius Research LLC - Equity Analyst

John, Sean, nice results. I want to just circle back on the USM sales. In the opening remarks, you mentioned meaningful uptick. So I'm just curious, has that trend continued into the current quarter?

And then is the visibility on whole assets coming to market improving given that next year, the fleet's going to need to absorb probably 1,500 narrow-body aircraft through new aircraft deliveries and then also the return to service of GTF-grounded aircraft?

John Holmes - AAR Corp - Chairman of the Board, President, Chief Executive Officer

Yeah. Great questions, and you're citing all the right industry dynamics. So we did start to see a loosening of supply in the fourth quarter and that continued through the first quarter. That did drive a meaningful growth in our USM business for the first quarter.

I would say it still remains a dynamic environment, but we definitely are encouraged by the additional assets that we see coming to market that match our criteria, which is one of the reasons we made the investments that we did during Q1.

Scott Mikus - Melius Research LLC - Equity Analyst

Okay. And then also just thinking about the opportunity there. Correct me if I'm wrong here, but I think USM has been margin-accretive to Parts Supply's overall margins. So just wondering what's kind of the opportunity for this year, from a margin perspective, at Parts Supply if more USM does come available to market? Could this be a business that's running 14%, 15% operating margin business or operating margins this year?

John Holmes - AAR Corp - Chairman of the Board, President, Chief Executive Officer

Yeah. So again, a good question on Parts Supply. So distribution from a margin standpoint has been performing extremely, extremely well. In the recent quarters, if you look back through last fiscal year and even in this quarter, margin in USM has actually been depressed.

Historically, you're absolutely right, it's one of our higher-margin activities, but the supply, even though it's loosening up, it's still actually quite tight. And so the spread that we're able to make on assets in USM is narrow than it would be historically.

As, and again, we believe we're in the very early innings of this, as you see more supply come onto the market. And for the reasons you cited, we do expect that to occur over time. We would expect margins to expand from where they are today on USM.

Scott Mikus - Melius Research LLC - Equity Analyst

Okay, got it. And if I could squeeze a quick one on Aerostrat. It looks like another nice bolt on acquisition for the software solutions of your business. Just curious, is there any sort of agreement with the employees that they stay on for an X amount of time, just making sure that you're retaining the key men there?

John Holmes - AAR Corp - Chairman of the Board, President, Chief Executive Officer

Yeah, great question. And you're hitting on the right theme. And as much as the team that came with Aerostrat are extremely talented, we're really excited about the team that came with it. And we know this publicly, there is an earn out associated with the transaction that applies to the key team members. And so that's a three-year earn out, and we feel pretty good about their financial incentive to stay around.

But even more than the financial incentive, our goal is to fully integrate them into the AAR, the Trax team, and really help them grow. And we're encouraged, it's early days, obviously, but we're encouraged by kind of the two-way revenue synergy there.

And as much as Aerostrat already is in customers where Trax is not, and we are going to leverage the software position that Aerostrat has with some large airlines that aren't yet on Trax to make an entry for Trax.

Conversely, Trax provides services to dozens and dozens of customers where Aerostrat is not yet providing services. And so our goal is to add the Aerostrat functionality to the Trax offering and sell that as an additional service to the Trax customer. So a lot of exciting conversations amongst our software team.

Scott Mikus - Melius Research LLC - Equity Analyst

All right. Thank you.

Operator

Sam Struhsaker, Truist Securities.

Sam Struhsaker - Truist Securities - Analyst

Hi, guys. Thanks for taking the question. On for Mike Ciarmoli, and nice results as well. I think in the results, you guys mentioned that you've been investing a little bit in inventory to support the strong demand in Parts Supply. I was just curious how we should think about -- are you guys kind of satisfied with where you are with inventory or maybe where you might be going with that as growth continues?

John Holmes - AAR Corp - Chairman of the Board, President, Chief Executive Officer

Yeah, this was a big investment quarter. We saw a lot of opportunities across the full parts of our segment, both in distribution as well as in USM. As we mentioned, we are encouraged by the opportunity to make investments in that business to support its continued rapid growth. But at the same time, we've got to focus on being cash positive for the rest of the year, so we want to balance those priorities.

Sam Struhsaker - Truist Securities - Analyst

Great, I'll keep it at one for now. Thank you.

Operator

(Operator Instructions) Noah Levitz, William Blair.

Noah Levitz - William Blair Capital Partners - Analyst

Thanks. John and Sean, good afternoon. Thanks for taking my questions. To start off, this is more strategic or high-level question. But a lot of your peers have commented on the notable strength specific to the engine aftermarket. So can you talk about your exposure, whether across Parts Supply or Repair and Engineering, to engine-related aftermarket services, any key themes or just puts and takes there? Thanks.

John Holmes - AAR Corp - Chairman of the Board, President, Chief Executive Officer

Yeah, absolutely. I mean, we have significant engine market exposure.

For example, in the USM business, 80% of our parts business in USM are engine parts. In our distribution business, we distribute engine-related accessories. Our largest line of Unison, for example, which is a unit of GE, are all engine-related parts, and that's our largest single product line within distribution. So the majority of the parts activity in the Parts Supply segment is related to engines.

Also related in the component services business, we have significant engine-related capabilities, particularly in our Grand Prairie operation in Texas. And that's an area where we continue to -- or we expect to continue to develop repair capability either independently or in conjunction with OEMs like GE. So I would say across the company broad engine exposure, which is helping to drive the significant growth that we've been demonstrating.

Noah Levitz - William Blair Capital Partners - Analyst

Awesome, and then just another quick one drilling in on Trax. Can you talk about how far along you are making Trax into more of an e-commerce marketplace, which can hopefully lead to more cross-sell opportunities with your parts distribution business? What trends are you seeing there? Thanks.

John Holmes - AAR Corp - Chairman of the Board, President, Chief Executive Officer

Yeah, thanks for asking about that. Again, really encouraged with the continued market uptake on Trax. mean, the challenge Trax has right now is just managing and prioritizing all the opportunities that they have in front of them, which is a great challenge to have.

As it relates to the marketplace initiative in general, we are investing in that initiative. It is very important to us. We see significant synergy between the Trax's operative base, the data that they traffic in, and ultimately, leveraging their position to offer parts of repair solutions through the Trax interface to their customer base and even beyond the Trax customer base.

Those are investments that we're making right now. It's a very active project inside of AAR, and I would expect that in the first half of 2026, we'll have announcements to make in terms of the progress that we've made there.

Noah Levitz - William Blair Capital Partners - Analyst

All right. Thank you.

Operator

Thank you. Ladies and gentlemen, I am showing no further questions in the queue. I would now like to turn the call back over to management for closing remarks.

John Holmes - AAR Corp - Chairman of the Board, President, Chief Executive Officer

Great. Thank you, and really appreciate everybody's time today and look forward to discussing our Q2 results in a few months. Thank you.

Operator

Ladies and gentlemen, that concludes today's conference call. Thank you for your participation. You may now disconnect.

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