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# EDITED TRANSCRIPT

AIR.N - Q2 2026 AAR Corp Earnings Call

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## CORPORATE PARTICIPANTS

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## CONFERENCE CALL PARTICIPANTS

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**Michael Leshock** *KeyBanc Capital Markets Inc - Equity Analyst*

**Scott Mikus** *Melius Research LLC - Equity Analyst*

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## PRESENTATION

### Operator

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

I would now like to hand the conference over to Chris Tillett, Vice President of Investor Relations. You may begin.

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### Chris Tillett - AAR Corp - Vice President - Investor Relations

Good afternoon, everyone, and welcome to AAR's fiscal year 2026 second-quarter earnings call. We're joined today by John Holmes, Chairman, President, and Chief Executive Officer; and Sarah Flanagan, Interim Chief Financial Officer. The presentation we are sharing today as part of this webcast can 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 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 the risk factor 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. The reconciliation of these non-GAAP measures to the most comparable GAAP measure 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.

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

Great. Thank you, Chris. And welcome, everyone, to our second-quarter fiscal year 2026 earnings call. This was another outstanding quarter for AAR as we generated strong results across all areas of our business. We also completed two key strategic acquisitions and announced

the third, which is expected to close in our fiscal fourth quarter. We are excited about these acquisitions as they enable us to accelerate our strategic objectives in two key areas of our business, our high-growth Parts Supply business segment, specifically new parts Distribution, and in our Repair & Engineering segment.

Turning to slide three. I would like to start with the key takeaways from the quarter. First, we delivered strong financial results with sales growth across all segments. Our 16% total sales growth was led by our Parts Supply business, which was up 29% in the quarter. This growth was driven by above-market organic sales growth of 32% in our new parts Distribution activities. This has been our fastest-growing activity, averaging more than 20% organic growth in each of the last four years. Our two-way exclusive distribution model resonates with OEMs and is helping to drive continued market share gains.

Second, we strengthen our portfolio with two strategic acquisitions. We previously shared that we are committed to enhancing our offerings with targeted acquisitions that advance our strategy, and we are delivering on that promise.

Third, we continue to capture new business across the company, including the renewal of key exclusive new parts Distribution agreements, as well as new customers for Trax. In addition, we are continuing to enhance our digital capabilities, including, through our newly announced partnership with Aeroxchange, the premier commercial aviation supply chain secure network provider.

Fourth, we are carefully managing our balance sheet to maintain strategic flexibility. And we ended the quarter with lower leverage, which is now within our long-term target range.

Turning to slide four. We have a number of accomplishments within the quarter regarding our four strategic objectives, which are: new business wins, operational efficiency, software and IP-enabled offerings, and discipline portfolio management. I will highlight two of the objectives on this slide, new business wins as well as software and IP-enabled offerings, with additional items to be discussed later in the presentation.

First, our Distribution model is unique in the industry in that nearly all of our distribution contracts, which typically range from 5 to 10 years, are two-way exclusive. meaning we do not represent competing product in a given market and our OEM partners do not use a competing distributor. This model allows us to develop deeper relationships with our OEM partners, become technically proficient in their products, and help them take market share.

This differs from a traditional distribution model where you acquire inventory and essentially act as a call center. We developed this approach more than 10 years ago and over the last several years have seen a 100% renewal rate in our contracts. Speaking of renewals, during the quarter we announced the renewal of two key exclusive contracts with Collins Aerospace and Arkwin Industries, which is a unit of TransDigm.

We are also leveraging synergies between our repair offering and our Distribution activities. During the quarter, Eaton, one of our key new parts Distribution OEM partners, named our Amsterdam facility as an authorized service center to support their hydraulic components across Europe, the Middle East, and Africa. This is a great example of the critical role our Parts Supply and Repair & Engineering businesses play in the aviation value chain and the synergies that exist within our operating activities.

Within our Repair & Engineering business, we continue to make progress on our Oklahoma City and Miami airframe heavy maintenance expansions. Both expansions are progressing well and will come online in calendar 2026, adding approximately \$60 million in annual revenue.

During the quarter, Trax announced an agreement with Aeroxchange. Aeroxchange is a leading provider of secure commercial aviation supply networks, and this agreement will enhance our integration capabilities with our customers. Trax customers will gain access to Aeroxchange's extensive networks of parts, repair, inventory pool, and consignment service suppliers through Trax applications. This collaboration advances our strategy to make it easier for Trax customers to buy parts and repairs.

One more thing on Trax. We were excited to announce yesterday that Trax has been selected by Thai Airways, one of the most important Asian carriers, to provide its eMRO enterprise resource planning system, suite of e-mobility apps, and a cloud hosting solution.

Turning now to slide five with more detail -- I'll provide more detail on our recent acquisition of ADI. We acquired ADI in September for \$138 million. ADI is a leading distributor of electronic components and assemblies and it closely aligns with our strategic objective to expand our rapidly growing new parts Distribution activities within our Parts Supply segment.

As mentioned, new parts Distribution has been growing at over 20% for the last four years and ADI will add a new growth vector to this activity. The addition of ADI moves AAR up the supply chain through ADI's production-facing distribution channels. This means we will now supply parts to our OEM partners for use in their own manufacturing. We plan to leverage our OEM relationships to grow ADI's business.

With approximately \$150 million in sales over the last 12 months and a team of 400 skilled employees, we are increasing our access to a substantial and rapidly growing total addressable market. Additionally, over time, we see opportunities to improve margins through higher volumes and operational efficiencies. ADIs performed above expectations in the first few months, and the integration is progressing as planned.

Turning now to slide six. I would like to provide an overview of our acquisition of HAECO Americas. We acquired HAECO Americas in November for \$77 million, extending our leadership position in airframe heavy maintenance. Through our investments in proprietary systems and processes, we've achieved industry-leading quality and turnaround times and have become the most sought-after airframe heavy maintenance provider in North America.

While new parts Distribution has been our fastest-growing business, airframe heavy maintenance has been the largest contributor to our margin expansion over the last four years. This acquisition builds on that success. HAECO Americas operates facilities in Greensboro, North Carolina and Lake City, Florida. As part of the integration process, we will be applying our successful operating model to these facilities to improve their operational and financial performance. This process will take 12 to 18 months and has three key elements: revenue optimization, cost reduction and process improvements, and footprint rationalization.

With respect to optimizing revenue, as part of the acquisition, we announced approximately \$850 million of new contract awards with several customers over five years. These contracts will replace the existing revenue base at HAECO and more closely match the key terms we have with our other airframe heavy maintenance customers.

With respect to cost reduction and process improvements at the HAECO facilities, our actions to adjust the cost structure to match the new revenue base are already well underway. Additionally, over time, we would deploy our proprietary processes and systems to the facilities to achieve the same quality and efficiency levels we've achieved at our other airframe heavy maintenance facilities.

Regarding footprint rationalization, we will be exiting our heavy maintenance site in Indianapolis over the next 18 months and transferring that work to other AAR sites with much of it moving to the HAECO facilities. As a result of our lease agreement with the airport, Indianapolis is our highest cost location. Additionally, labor availability has been a persistent challenge. By exiting this high-cost location when the lease expires and redistributing the work throughout the rest of our network, we will further improve the overall margin profile of our airframe heavy maintenance activities.

As mentioned, all of these actions will take 12 to 18 months to complete and will initially be margin dilutive. However, we expect the margin to steadily improve as we move through the integration process. Once this work is complete, we will have added approximately 40% additional capacity to our network, lowered our fixed cost, and gained access to a more predictable labor supply. Most importantly, we have the support and contractual commitments from our customers to execute this plan.

Turning now to slide seven. We also recently announced an agreement to acquire Aircraft Reconfig Technologies, or A-R-T, for \$35 million. A-R-T specializes in reconfiguring passenger aircraft interiors providing project management, engineering, and certification solutions. This

is an exciting addition to our airframe heavy maintenance capabilities that expands our ability to perform complex aircraft modification work while bringing proprietary solutions and a robust IP portfolio.

It also brings engineering and self-certification capability that can accelerate our Parts PMA development efforts. We expect this acquisition to close in the fourth quarter of this fiscal year, and we look forward to welcoming the skilled team to AAR.

With that, I'll turn it over to Sarah to discuss the results in more detail.

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**Sarah Flanagan - AAR Corp - Interim Chief Financial Officer**

Thanks, John. Looking now to slide eight. Total sales in the quarter grew 16% year over year, including 12% organic growth to \$795 million. We drove growth in each of our segments with particular strength in Parts Supply. Sales growth to government customers increased 23% and sales to commercial customers increased 13% 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 23% to \$96.5 million, and adjusted EBITDA margins increased to 12.1% from 11.4%. Adjusted operating income increased 28%, to \$81.2 million, with adjusted operating margins improving 100 basis points from 9.2% to 10.2%.

Our focus on improving operating efficiencies, strong performance in our Parts Supply segment, and government programs were key drivers of the improved margins. The combination of sales growth and margin expansion resulted in a year-over-year adjusted diluted EPS increase of 31%, to \$1.18 a share from \$0.90 a share in the same quarter last year.

With that, I'll turn to the detailed results by segment, starting with Parts Supply on slide nine. Total Parts Supply sales grew 29% from the same quarter last year to \$354 million. We once again saw above-market growth in our new parts Distribution activities, which grew 32% as compared to last year, excluding the contributions from ADI. Second-quarter Parts Supply adjusted EBITDA of \$46.5 million was higher by 37% and adjusted EBITDA margin increased to 13.2% from 12.4% in the same quarter last year.

Adjusted operating income rose 35% to \$42.8 million and adjusted operating margins also increased from 11.5% to 12.1%. Higher margins were largely driven by increased operating leverage as we are successfully scaling our business while maintaining cost discipline.

Turning now to slide 10 for Repair & Engineering. Total sales increased 7% year over year to \$245 million. Demand remains strong for our airframe heavy maintenance activities, and we continue to drive efficiency to increase throughput. Adjusted EBITDA of \$31.2 million was 1% higher than in the same period last year, while adjusted EBITDA margins decreased to 12.8% from 13.5%. Second-quarter adjusted operating income of \$27.4 million remained consistent to the same period last year, with adjusted operating margins decreasing to 11.2% from 12.0%. This was largely due to the mix of work within our airframe heavy maintenance network, one-time costs and component repair, as well as a slight impact on the HAECO America's acquisition, as we only had one month of HAECO operations included in the quarter.

As John mentioned earlier, we have initiated our integration activities and expect to improve their operating margin over the next 12 to 18 months, taking them from low-single-digit EBITDA margin to margins in line with our current Repair & Engineering margins. Going forward, we expect to continue to drive margin expansion in this segment through the improved performance of our two newly acquired HAECO facilities, driven by integration and synergy actions, continued rollout of our paperless hangar initiatives, increased volume into our component repair facilities, and the hangar capacity expansions that are in process.

Looking now to slide 11. Integrated Solution sales increased 8% year over year to \$176 million, primarily driven by government programs. Integrated Solutions adjusted EBITDA of \$18.5 million was 50% higher than the same period last year. Adjusted operating income of \$15.1 million was 82% higher with the adjusted operating margin increasing from 5.1% to 8.6%. Higher margins were driven by favorable mix and certain government contracts achieving key program milestones during the quarter.

Turning to slide 12 of the presentation. During the quarter, our net debt leverage decreased from 2.82 times in the first quarter to 2.49 times, achieving our target range of 2.0 to 2.5 times. This decrease was driven by double-digit earnings growth, continued balance sheet management, and our equity offering.

Turning to slide 13 of the presentation. With respect to our capital allocation strategy, our priorities remain unchanged. First, we will continue to fund organic growth in each of our three core areas: our high-growth new parts Distribution activities, our airframe-heavy maintenance and component repair activities, and our software and IT-enabled offerings. Second, we'll allocate capital to M&A opportunities to meet our strategic and financial criteria and support our core segments.

The three acquisitions we have discussed today, ADI, HAECO Americas, and A-R-T, are all well aligned with our stated criteria and will help to accelerate our growth strategy of bringing our unique platform to market as a premier independent provider of aviation parts, repair, and software. As we look to Q3, we expect to be cash positive in the quarter. We also expect interest expense to be slightly lower than the prior quarter.

With that, I'll turn it back to John.

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

Great. Thank you, Sarah. Turning to slide 14. We have an update on our outlook for Q3 and for the rest of our fiscal year.

For Q3, we're expecting total sales growth in the range of 20% to 22%, which includes the impact of our two recent acquisitions. For reference, organic sales growth for Q3 is expected to be 8% to 11%, which excludes the divestiture of Landing Gear as well as the impact of the ADI and HAECO acquisitions. For margin, we expect Q3 adjusted operating margin of 9.8% to 10.1%. For the full fiscal year, given our strong performance in the first half and including our two recent acquisitions, we expect total sales growth approaching 17% and organic sales growth approaching 11%.

In closing, I would like to highlight AAR's strength as a business and as an investment. We are well positioned in the most attractive segments of a growing aviation aftermarket. We have a broad, unique platform as a provider of parts, repair, and software that is unmatched in our industry. Our complete range of aftermarket solutions work together to drive a sustainable, self-reinforcing cycle of growth. We have enhanced our portfolio with high-quality acquisitions, and we are delivering stronger growth and higher margins.

I would like to thank our talented team of global employees, particularly Sarah, for their dedication as they deliver excellence, quality, safety, and the critical work that we do for our customers every day. I would also like to thank our customers and our shareholders for your continued interest and support of AAR.

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

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions)

Ken Herbert, RBC.

**Ken Herbert** - RBC Capital Markets Inc - Analyst

John and Sarah, really nice quarter. John, maybe just to start. On the Parts Supply, how do we think about with the 32% growth, is it possible to parse that out a little bit more by, say, volume versus price? And if you're seeing anything unique on the price side from an airline perspective? And then within volume, how we think about maybe sort of same-store sales of that versus sort of new contract wins or expansions to the portfolio in the quarter?

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

Yeah. I would say -- great question. I would say, overall, it's volume driving that growth. So the majority of that growth is driven by volume. Sure, we've had some price escalation with certain of our OEM partners, but that would be not the majority of that.

And then in terms of same-store sales, we are seeing significant growth out of existing distribution contracts that are, again, in that kind of 20% to 30% range, which is obviously driving the overall growth. So it is volume, it is new contracts ramping up, but it's also really healthy same-store sales performance.

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**Ken Herbert** - RBC Capital Markets Inc - Analyst

That's helpful. And as you think about moving here to calendar '26, the second half of your fiscal year, are there any concerns or are you seeing any risk about destocking at your airline customers after, obviously, several years of what seems to be maybe some buffer inventory level building there?

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

Yeah. Great question. And the answer is no. We're not seeing evidence of that. The backlog for that business gives us confidence that the growth rates that we're seeing there are going to continue. And at this point, no signals that would imply destocking.

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**Ken Herbert** - RBC Capital Markets Inc - Analyst

Perfect. And just finally, if I could, the implied third-quarter margin represents a bit of a step down sequentially. I'm guessing this is really mixed as you think about the acquisitions, but anything else going on besides mixed in terms of sequentially second to third quarter on the margins?

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

No, that's the driver. As we mentioned, you know, around the HAECO acquisition, you know, long-term that will be margin accretive. In fact, since we've gotten into it, we expect it will be even more margin-accretive than we thought when we did the deal, which is a great thing. But it is going to take us a couple quarters to move through that integration to get there, and you're going to see the impact of that in Q3 and Q4.

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**Operator**

Louie DiPalma, William Blair.

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**Louie DiPalma** - William Blair Capital Partners - Analyst

John, Sarah, and Christopher, good afternoon, and happy 2026.

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

Hey, Louie, happy 2026.

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**Louie DiPalma** - William Blair Capital Partners - Analyst

John, you became the heavy maintenance industry leader with the HAECO Americas deal. Do you see synergies with heavy maintenance and your other businesses, such as your component repair business and also with Trax?

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

Yeah. Absolutely, and great question. For sure, there are synergies between the heavy maintenance business and the component business. And we -- part of our strategy is to leverage the leadership position that we have in airframe heavy maintenance to drive volume to our component shops. Some of that comes from just having possession of the aircraft themselves.

We now have well more than a thousand aircraft moving through our facilities each year and that generates individual component repairs that we can perform. But mostly it's going to be by doing deals with our customers where we sign up long-term commitments on the heavy maintenance side that are coupled with long-term commitments on the component repair side.

And I just want to highlight, we've invested a lot in proprietary systems and processes inside our hangars, and we have now achieved industry-leading turnaround time and quality. Our turnaround times are particularly important to the customers because let's just say a heavy maintenance visit is going to take 30 days, a typical is going to take 30 days. If we can deliver that aircraft back to our customer in 28 days or 27 days, they love that because that's extra days that they have to put that aircraft back in revenue service. And that's worth a lot. And that operational performance inside our hangars is driving the demand that we're seeing.

And as I mentioned, when all this is said and done, we will have added 40% capacity and that's sold out through the end of the decade. So that's a lot of demand and we plan to leverage that leadership position again to drive volume through the component shops.

As it relates to Trax in particular, Trax has synergy predominantly with our Parts Supply business. We intend to develop proprietary channels to market to sell new and used parts through Trax, and then also through component repair. The Aerostrat acquisition that we made last quarter does have direct synergy with heavy maintenance because that software allows customers to plan long-range heavy maintenance visits and of course that feeds directly into the HEAVY MAINTENANCE offering that we provide.

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**Louie DiPalma** - William Blair Capital Partners - Analyst

Excellent. And also, you announced the win yesterday with Thai Airways. And I'm wondering, has the landmark win with Delta Airlines that you announced over the summer, has that stimulated the pipeline? As many airlines, they often follow Delta's lead, given Delta's role as one of the largest MROs in addition to one of the largest airlines.

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

Yeah. The answer is absolutely. And that's one of the reasons we were so focused on securing Delta as a win early on in our journey with Trax, because Delta is not only the largest, but it's an extremely well-respected airline amongst all airlines. And so the fact that they have selected Trax and endorsed that as a solution that can scale up to their size is hugely beneficial. And absolutely, that has opened doors for Trax.



We -- the other thing I would just mention is that it's approximately a three-year implementation at Delta, so we're about seven months into that. It is going very well, and Delta has been willing to serve as a reference for us with other customers, which we're grateful for.

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**Operator**

Michael Leshock, KeyBanc Capital Markets.

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**Michael Leshock** - KeyBanc Capital Markets Inc - Equity Analyst

I wanted to ask on M&A. You've been highly acquisitive as of late, and you mentioned capital allocation priorities are unchanged. Do you see opportunities for further M&A over the next maybe 6 to 12 months, or is there more of a shift to integration? Just any thoughts you can provide on the M&A pipeline and what you're seeing there? And then maybe what segments you might target going forward.

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

Sure. The short answer is yes. We continue to believe that and continue to see M&A as a key part of our growth. And one of the things I'm particularly proud of is, out of the last several deals that we've done, these have all been self-sourced. We have gone to these companies, we have developed relationships with the owners and we -- so all the deals that we've closed in the last three years, they've been sourced by us.

So we've got very specific criteria that acquisitions need to meet. There are several other companies out there that we believe can meet that criteria, and we are actively pursuing them. We feel that we have the integration muscle, if you will, moving inside the company. We're definitely cognizant of our own bandwidth, so we want to make sure that we're successful with the integrations that are underway right now. But we also want to be in a position to curate attractive M&A opportunities and close on them.

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**Michael Leshock** - KeyBanc Capital Markets Inc - Equity Analyst

Great. And then one more question on Trax, if you could provide any color on Trax in the customer upgrade cycle, whether that be the percent of customers that have already upgraded or the timing of when you expect more upgrades to occur. I know it's a multi-year event, but any more color on Trax would be great.

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

Thanks, Michael. Great question there. We're approximately, I'd say, 30% -- 30% to 35% of the way through the customer upgrades. And that's customer upgrades that have been agreed to but potentially not yet implemented. So we have a lot of current upgrades going on that are in various stages of implementation.

Our goal is to have all of that completed by the end of 2028. Like any software upgrade cycle, it may take longer. But our goal is to have the bulk of this done by 2028.

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**Operator**

Scott Mikus, Melius Research.

**Scott Mikus** - Melius Research LLC - Equity Analyst

Hi. Yes, can you hear me?

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

Yeah. Hey, Scott. How are you?

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**Scott Mikus** - Melius Research LLC - Equity Analyst

Sorry about that. John, I wanted to ask on the ART acquisition. We're seeing a lot of airlines announce interior refreshes. They try to better segment their cabins and increase the premium offerings. I'm just kind of wondering if you could provide what's the revenue now. What kind of growth CAGR do you see there, say, over the next three, four years? And what's the margin potential for that business?

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

Yeah, appreciate the question. We didn't disclose the revenue, but what we can say is that, that is one of the main reasons we decided to make this acquisition. This is a market we do participate in a limited way today, but ART brings much-needed engineering, IT, and self-certification expertise to allow us to become a much bigger player in that market.

And you hit the nail on the head. This is an area that is very strong now and expected to grow as airlines are constantly looking to refine their offering and reposition the resources inside of their cabin to meet the demand. And this acquisition puts us in a really strong position to participate in that market, coupled with our heavy maintenance offering.

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**Scott Mikus** - Melius Research LLC - Equity Analyst

Okay. And then one more quick question. I mean, I think last quarter you mentioned there was a meaningful pickup in USM sales. Just wondering if that trend continued this quarter? And are airlines maybe reconsidering retiring aircraft and parting them out, just given that demand looks like it's improved in recent months and now fuel prices are pretty low?

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

Yeah. I would -- so we saw about the same level of activity in USM this quarter as we did last quarter. And I would say there's been no material change in the market in terms of availability since what we discussed last quarter. So it's pretty much status quo. But we're really focused, as you can tell, on the new parts distribution business, which has exceptional momentum in the market right now and it continues to gain wide acceptance.

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**Scott Mikus** - Melius Research LLC - Equity Analyst

Okay. And then a quick one for Sarah. I just wanted to clarify. I think you said new parts distribution sales were up 32% organically. I was wondering if you could parse that out maybe between commercial and government?

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**Sarah Flanagan** - AAR Corp - Interim Chief Financial Officer

Yeah. I would say, in the quarter, roughly 50% of that growth came from commercial, and the other 50% came from defense. So we had a really strong quarter on both fronts.

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**Operator**

Ken Herbert, RBC.

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**Ken Herbert** - RBC Capital Markets Inc - Analyst

John, on the USM front, one of your major partners, FTAI, has announced an aero-derivative IGT offering for the CFM56. It sounds like overall activity for you on that engine with FTAI may have been trending down. But do you see this potentially as a risk longer term to engine volumes, perhaps, for your USM business as we maybe see more traction of aeroderivative engines into non-aerospace markets?

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

No. I appreciate you asking the question. I really don't see it as a risk. You know, in the immediate term, as you just indicated, you know, FTAI -- and they're a great partner. They've had such demand for these assets that we have seen our activity with them decline significantly over the last year plus. Yet, our team in the USM business has been able to continue to source CSM material out in the market to basically make up for the lack of volume with FTAI.

Our skill in the USM business is finding material in the market where others cannot. And I'm very confident that, you know, despite, you know, potentially this new demand vector for that engine, we'll continue to be able to find material.

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**Operator**

(Operator Instructions) I'm showing no further questions in the queue. I would now like to turn the call back over to John for closing remarks.

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

Well, it looks like we have some more questions.

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**Operator**

Yes, they just popped up. One moment.

Michael Ciarmoli, Truist Securities.

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**Michael Ciarmoli** - Truist Securities - Analyst

Thanks for getting me in there, guys. Not sure what was going on, but real nice results. John, just how should we think, you know, you've given sort of the annual guidance in terms of revenues. You know, we've got some dilution on the margins. Any thoughts on how we should think about that adjusted operating margin and maybe call it a 10% ceiling when you can kind of firmly punch through that?

It does seem like, I guess, with more of a full quarter, you kind of talked about it, you get a little bit of that dilution from HAECO. It's going to take a little bit. Anything in terms of how we should think about those adjusted margins going forward, you know, taking into account the synergies, the cost out, and some of the other benefits?

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

Yeah. I would say, you know, first of all, we're really pleased with the trajectory we've been on, right? You know, this is, you know, only the second time we've been above 10% in the quarter. We're up a full point from last year. And, you know, I think as we've said in various settings, we see, you know, the ability to achieve a couple points above where we are now.

The HAECO integration is going to be a near-term dilutionary, as you said, for the next couple of quarters. But as a result of the integration, as a result of exiting our higher cost location in Indianapolis, we feel very good about punching above that 10% level over time.

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**Michael Ciarmoli** - Truist Securities - Analyst

Okay, okay. And then just on the revenue outlook for the year, do you have any contributions from the new capacity coming online in this current fiscal '26 guidance? Or is it going to be a more pronounced positive impact next year?

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

It'll be a more pronounced positive impact next year. Yeah. It'll be a more pronounced positive impact in our FY27. We will see a slight contribution from the Oklahoma City site that'll come online likely in February timeframe. But the Miami site will come online fully in, call it, July timeframe. So both of those will be at full run rate for our FY27.

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**Michael Ciarmoli** - Truist Securities - Analyst

Perfect. And then I'm going to ask you this one anyway. I get this question a lot from clients and have gotten it. Just from the rationale to expand that lower margin MRO heavy maintenance, you know, it often gets perceived as the wrench-turning aspect of the business. I mean, to me it makes a lot of sense, but, you know, you're kind of adding to the lowest margin portion of your business. I know you talked about the synergy.

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

I'm really --. Yeah, go ahead.

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**Michael Ciarmoli** - Truist Securities - Analyst

Just the thoughts on maybe skewing more towards that higher-margin Parts business or how should we think about it? How should investors really think about that when they see you deploying capital there?

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

Yeah. So I'm really happy that you were able to get the question in because that's one that I'm happy to answer. It is not a low-margin business. We have made more margin gains in the heavy maintenance area since coming out of COVID than anywhere else. So now that business is a low-double-digit margin business with potential to expand as a result of this acquisition as we improve the fixed cost base.

Not only that, we now have circa 45%, 50% market share, and the customers are coming to us. And so the investments that we've made in our processes that improve the turnaround, as I described, I mean, they're allowing us to sell out through the end of the decade and, in certain cases, achieve the premium in the market. So that business, I think, is misunderstood.

If you look at the margins in our Repair & Engineering segment and look at them compared to other publicly traded MROs that trade differently than we do, they're actually pretty similar. And we're telling you that we can expand margins from here. So I think the historical view that airframe is a tough business, it's low margin, et cetera, it is a tough business, but we've developed a model that is succeeding significantly. And that's thanks to our execution and the systems that we put in place.

So I'm really excited about the HAECO acquisition and the potential for further margin expansion across all the heavy maintenance.

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**Operator**

[Sheila], Jefferies.

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**Unidentified Participant**

Congrats on a great quarter. John, maybe on the last line of questioning, if that's okay, sticking to Repair & Engineering. Maybe, I guess, just bigger picture, how do you think about margin expansion within the segment?

And then second, as we think about HAECO, and I know you already talked about it with Mike a little bit, how do you think about going from 3% margins or low-single-digits to double-digit margins? How much of that comes from the contract realignment versus the cost rationalization?

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

I think it's -- so I would say, in general, in the segment, we would see -- going back to the levels that we were a year ago in terms of margins, so low double-digit, and then expanding from there. So I would view the moment that we're in right now under Repair & Engineering as a low point. We've got a couple quarters to get through as we get through the bulk of the real heavy lifting as it relates to the HAECO acquisition, but then we'll go up from there, and then ultimately exceed where we were prior to this. And again, as I mentioned, we've got the customer support and the customer commitments over a multi-year period to achieve all of that.

So feel good about the overall margin possibility in Repair & Engineering. And one other thing I should mention is that I'm talking about heavy maintenance. The component repair business is a mid- to high-teens operating margin business. And as I talked about earlier, we intend to leverage the leadership position that we have in heavy maintenance to drive more volume to component repair, which will further enhance the margins of the overall segment.

As it relates to the HAECO integration in particular, it would be a mix between the revenue realignment and the cost takeout. And I should mention that we are taking the revenues down from what HAECO was doing before pretty significantly. And so we're bringing the volume across the facilities down to a level where we can establish our processes, establish the rigor that we want to see, that we've been able to achieve elsewhere on the floor, in the hangars, and then ultimately build up from there.

So we're utilizing -- we're not utilizing the full footprint. We're right-sizing the labor force to match the volume to get the operations performing the way we want. But then over time we would intend to build up from here. And I should mention that we've done that successfully in several of our other existing facilities and we're obviously doing that in Miami and Oklahoma City because we're expanding those two sites.

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**Unidentified Participant**

Yeah. Great. And then maybe just switching gears a little bit, lots of questions already on your success in parts distribution accelerating over 30% in the quarter. Can you talk about what you're expecting -- Sarah mentioned 50% of that came from government customers. What you're thinking about the second half of the year?

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

Yeah. I would say, you know, again, we've been kind of on an annual run rate of, you know, circa 20% organic growth. And I would think that we would be, you know, slightly above that in the second half of the year.

**Operator**

Thank you. I'm showing no further questions at this time. I would now like to turn the call back over to John for closing remarks.

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

Great, really want to thank everybody for the time and the interest. As you can tell, we've got a strategy that's working. We're encouraged by the momentum that we have, and we expect it to continue and look forward to getting back together next quarter. Thanks, everybody.

**Operator**

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

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