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Q4 2024 AAR CORP EARNINGS CALL

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## CORPORATE PARTICIPANTS

- **John Holmes** AAR Corp - *Chairman of the Board, President, Chief Executive Officer*
- **Sean Gillen** AAR Corp - *Chief Financial Officer, Senior Vice President*

## CONFERENCE CALL PARTICIPANTS

- **Operator**
- **Michael Ciarmoli** Truist Securities, Inc. - *Analyst*
- **Bert Subin** Stifel, Nicolaus & Company, Incorporated - *Analyst*
- **Scott Mikus** Melius Research LLC - *Analyst*
- **Louie DiPalma** William Blair & Company L.L.C. - *Analyst*
- **Ken Herbert** RBC Capital Markets - *Analyst*

## PRESENTATION

### Operator

Good afternoon, everyone, and welcome to AAR's fiscal 2024 fourth quarter earnings call. We're joined today by John Holmes, Chairman, President and Chief Executive Officer; and Sean Gillen, Chief Financial Officer.

Before we begin, I would 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 the risk factor section of the company's annual report on Form 10-K for the fiscal year ended May 31, 2024, which we expect to be on file with the SEC shortly. In providing 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 on the call today. A reconciliation of these non-GAAP measures to the most comparable GAAP measures is set forth in the company's earnings release. A replay of this conference call will be available for on-demand listing shortly after the completion of the call 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*

Thank you, and thank you to everyone for joining us this afternoon. We are very proud of the record performance we delivered during our FY24. I want to thank our team for their tireless efforts. AAR advanced strategic initiatives, sharpened focus completed our largest ever acquisition and we executed well across the company.

We are benefiting from structural tailwinds from high levels of air travel and an aging fleet, which drives demand for our aftermarket services. Our company is more focused than ever before within our three main segments, parts supply, repair and engineering, and integrated solutions. We are making investments in each of these three segments to drive growth improve our efficiency and deliver

higher margins. We saw the benefits from these investments in our FY24 and expect them to continue in our FY25.

With that, I will turn to the FY24 results more specifically. We delivered record full year sales of \$2.3 billion, up 17% over the prior year. Our adjusted operating margins increased from 7.5% to 8.3% in fiscal 2024, which only reflects one quarter of ownership of the higher margin Triumph product support business. And we generated record adjusted diluted earnings per share from continuing operations of \$3.33 compared to \$2.86 last year.

Our fourth quarter was a record ending to a record year. Sales increased 19% year-over-year, driven by the impact of the product support acquisition and strong performance in our distribution and government integrated solutions activities. Adjusted operating margin improved by 150 basis points year over year from 7.8% to 9.3% due to the contribution from product support and our solid execution in both parts supply and airframe maintenance.

Given some of the changes that we have made to the portfolio, I'm now going to go into the results in a little more detail for each of our three segments. Part supply, parts supplies, are largest and most profitable segments and where we have very significant opportunity for organic growth. This segment contains two activities, new parts distribution and used serviceable material or USM. Distribution represents about 55% of parts supply sales, distribution executed extremely well in the fourth quarter, posting the 10th straight quarter of double digit organic growth.

Revenue grew 16%, driven by additional government volumes, market share gains and continued commercial demand strength. We are the largest independent distributor of OEM parts and our independent status is a key strategic advantage, which eliminates conflicts and allows our OEM partners to serve all aircraft types.

We have deep relationships with a few key OEMs, and these are all on an exclusive basis. We continue to sign new exclusive agreements, and we have several meaningful wins in the quarter, including our multiyear contract extension and expansion with Sumitomo Precision Products to distribute its V2500 starter and value components. Our new multiyear agreement with Triumph to support its actuation product line and the expansion of our agreement with OTTO Engineering to distribute electromechanical components.

We are optimistic about continuing to gain market share and add new distribution lines at a similar pace going forward. Particularly as we move into electronic components and the business and general aviation end markets.

USM represents about 45% of total parts supply sales. It has also performed well in the quarter with sales up 1% year-over-year and up 7% sequentially despite extremely tight supply conditions. As a reminder, in this business, we acquire used aircraft engines design a disassembly and repair plan, have individual parts refurbished and then sell them to our customers at significant savings versus the new part alternatives.

We also acquire and resell whole aircraft and engines, which is an important activity and can create lumpiness in our results. Excluding these whole asset sales, USM sales parts growth was 38% in the quarter. This underlying growth in recurring used parts sales reflects our strong market position, underpinned by deep supplier relationships to source parts, significant expertise to evaluate assets and a world-class global sales force.

We continue to benefit from the increasing adoption of USM as airlines and MROs unlock the benefits of buying used, and we believe this will continue to be a tailwind to our business for years to come. Whole assets such as engines in particular, are in high demand due to the issues with the GTF and other new engine variants. This, coupled with relatively few aircraft retirements, is driving constrained whole asset availability.

However, we expect supply pressures to alleviate over the next few years based on the recovery of new aircraft production and improve new engine variant performance. This will lead to more aircraft and engine retirements, which will drive greater availability of individual parts and whole assets and allow us to continue our overall growth in USM.

Repair and engineering. Turning to repair and engineering, this segment consists of airframe heavy maintenance and component repair, including Triumph product support as well as our PMA parts initiatives. Revenue growth was 51% in the quarter. Excluding the product support acquisition, revenue was relatively flat as our hangars are nearly at capacity. That said, our hangar capacity expansions in Miami and Oklahoma City remain on track for operation beginning in the second half of calendar 2025. These expansions will add approximately \$60 million of annual sales.

At the beginning of the fourth quarter on March 1, we closed on the acquisition of Triumph product support, which brings increased scale and differentiated repair capability. The acquisition exceeded our expectations in Q4, and we are in the early stage -- stages of unlocking significant additional value.

In terms of cost synergy, we are beginning to consolidate our existing Long Island facility and the product supports Grand Prairie, Texas and Wellington, Kansas facilities. We are on track to achieve the previously announced associated cost synergy target of \$10 million by Q1 FY26.

The business also brings capability in-house that we can now use for repair work to support our commercial programs and USM refurbishment activities. In addition, we are leveraging our talented commercial aftermarket sales force and our government business development resources to further accelerate product support growth.

We also continue to make progress in our PMA initiative. We received FAA approval for several parts and have a significant additional pipeline that we are actively working to develop. We are in the process of integrating this initiative with the existing PMA business that came with the product support acquisition and remain committed to growing this combined PMA effort into a meaningful business over the next several years.

Integrated solutions. Turning to integrated solutions in this segment. We support government and commercial aircraft operators with the management of logistics and supply chains as well as the Trax software offering. The majority of what we do in this segment is supporting government customers. Our programs are long-term with an average tenure of five years, meaning this is an annuity business.

In general, we are managing the aftermarket needs of aircraft operators across parts, maintenance, sourcing and logistics and programmatic fashion. Revenue in this segment was up 10% from a year ago, and we saw greater volumes in our state department and F-16 programs.

As you know, we acquired the Trax software business a year ago, and the integration has gone well. Trax is the best in class maintenance ERP offering, which supports nearly 150 airlines and MRO customers globally. We are growing the core Trax business by introducing it to customers that may not have been able to reach previously and laying the groundwork for Trax to be a new sales channel for our core parts and services offerings. Trax is a high margin business and a long runway for growth.

That concludes the update for our three core segments. Our fourth segment expeditionary services, is non-core for AAR. Sales in this segment were down 30% due to continued depressed volumes in both pallets and shelters as the government prioritize spending on products that are supporting Ukraine forces. However, we now have visibility on funding going forward, and we expect volumes to normalize during FY25. Overall, I'm incredibly proud of the quarter and the year that we delivered.

And with that, I'll turn it over to Sean.

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

Thanks, John. Total sales in the quarter grew 19% to \$657 million. Excluding the impact from the recently acquired product support business, organic revenue growth for the quarter was 5.5%. Our consolidated sales to commercial customers increased 20% or 4% on an organic basis, with growth in all three of our core segments.

Our commercial distribution sales were a particular standout as we continued to drive sales growth on existing product lines and expanded newly won product lines as well. Our government sales increased 15% or 10% on an organic basis. An improvement from a 7% decline in the prior quarter. The organic sales increase was driven by an ongoing recovery across our government program activities and increased order volume for our new parts distribution activities.

Adjusted operating profit margin improved 150 basis points from 7.8% to 9.3%. On an organic basis adjusted operating margin also increased by 60 basis points, driven by parts supply and airframe maintenance. Adjusted EBITDA margin increased 200 basis points from 9.6% to 11.6%. We have a clear road map for continued margin improvement over the medium term, as our mix shift towards our higher-margin segments, we realize the product support synergies, we continue to rollout our airframe maintenance efficiency improvement initiatives and the new airframe maintenance capacity expansion projects come online.

Net interest expense for the quarter was \$18.7 million, reflecting the financing of the product support acquisition, and we expect Q1 interest expense to be approximately the same as Q4. Average diluted share count in the quarter was [35.4 million shares]. Our effective adjusted tax rate increased from 23.6% to 26.4%. And for FY25, we expect our effective adjusted tax rate to be approximately 28%. Adjusted diluted EPS increased from \$0.83 to a record \$0.88, reflecting the benefit of our growth and margin expansion. The product support acquisition was slightly dilutive to the quarter, but we expect it to be accretive to earnings in FY25.

With that, I'll turn to the detailed results by segment. Parts supply sales grew 9% to \$260 million, driven by 16% growth in distribution and 1% growth in USM. The growth in distribution was consistent with the double digit growth we've experienced over the last

several quarters as we continue to gain market share. Growth in the quarter was positively impacted by the continued ramp up of Arkwin and [AeroControlex], as well as greater purchases by both the US and foreign governments.

Our USM activities had a strong quarter as sales of USM parts were up significantly. However, this growth was largely offset by a decline in USM whole asset sales as supply remains constrained for these types of larger transactions. Parts supply adjusted operating margins increased by 130 basis points to 13.5% in the quarter, driven by distribution, which benefited from scale and mix. The improvement in distribution sales to government customers also contributed to the increase in margins.

Repair and engineering sales increased 51% to \$216 million. On an organic basis, sales were flat as growth in the hangars was offset by the roll-off of certain landing gear repair work. The product support integration is progressing well and this acquisition contributed \$73 million to revenue in the fourth quarter. Demand remains strong for our heavy maintenance and component repair capabilities, and we look to continue to drive growth in these activities.

Repair and engineering adjusted operating margin increased by 490 basis points to 11.5% in the quarter, driven by the inorganic impact from product support and continued efficiency gains in the hangars. Going forward, we expect to drive further margin expansion in this segment from the realization of product support synergies, rollout of our paperless hangar initiative and the capacity expansions once they come online in FY26.

Integrated solutions sales increased 10% to \$163 million, driven by growth in our State Department program, F-16 program and from Trax. Integrated solutions adjusted operating margin decreased by 120 basis points to 5.6% in the quarter based on the mix within government programs.

Turning to consolidated cash, cash flow provided by operating activities from continuing operations was \$25 million in the quarter as we reduced non-product support inventory by \$7 million. This cash flow generation and the EBITDA growth allowed us to delever from 3.6 times net debt to adjusted pro forma EBITDA at the closing of the product support acquisition for 3.3 times at the end of Q4. We are pleased with this reduction in leverage, and we'll continue to balance opportunities to invest in the business and continued debt reduction. Our balance sheet and capital structure afford us sufficient flexibility to manage our business and make decisions that maximize shareholder value.

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

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

Great. Thank you, Sean. Considering that this will be our first full year of results, including the margin accretive product support acquisition. We are updating our three to five year adjusted operating margin target that we communicated at last year's Investor Day to include the accretive impact of the product support acquisition.

We previously expected 9% to 10% plus adjusted operating margins. We are increasing that to 10.5% to 11.5% plus as a result of the product support acquisition and our increased confidence in hitting the targets that we laid out a year ago. This translates to 12.5% to 13.5% plus EBITDA -- adjusted EBITDA margins.

We're confident in our ability to deliver 5% to 10% average annual organic sales growth and an average annual growth of 10% to 15% on organic adjusted EPS over the next three to five years. With respect to FY25, we anticipate continued growth and margin expansion. And parts supply, we expect new parts distribution will continue to benefit from the ramp-up of new distribution lines and the growth in commercial aftermarket demand. In USM demand should continue to be very strong, although tight supply will likely limit revenue growth until more aircraft are retired over the next few years.

In repair and engineering, our airframe maintenance hangars will continue to be largely full, until our expansions in Miami and Oklahoma City come online in FY26. We expect to continue to drive greater efficiency and higher profitability out of our existing footprint in the meantime.

With respect to component repair, we expect to drive additional volume and margin expansion as we integrate and realize the synergies from the product support acquisition. And in integrated solutions, although new government awards during FY25 would likely not commence until FY26. Our pipeline of opportunity remains full, and we continue to be well positioned to support the DOD's interest in applying commercial best practices in support of the government fleets.

Looking to Q1 of FY25 specifically, we expect revenue growth of 15% to 19% and adjusted operating margin of approximately 9%. Last year at our Investor Day, we outlined a strategy and a vision, and we made tremendous progress in FY24 executing on those objectives. We continue to expand our leadership position and parts supply, broke ground on airframe maintenance expansions,

integrated Trax, completed our largest ever acquisition and drove higher margins through our investments in efficiency and differentiated capabilities. We are exceptionally well positioned to capitalize on the strength that we are seeing in our markets, and I'm very excited about our future.

With that, I'll turn it over to the operator for questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Michael Ciarmoli, Truist Securities.

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### Michael Ciarmoli *Truist Securities, Inc. - Analyst*

Hey, good evening, guys. Thanks for taking the questions.

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

Hey, Michael.

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### Michael Ciarmoli *Truist Securities, Inc. - Analyst*

John. Just on that last item you just said 9% margins. Is that just more seasonality driving that down sequentially? What are the puts and takes for the margins dip sequentially off the last quarter?

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

Yeah, that's exactly right. It's the seasonality. Even though the seasonality of the business is much less severe than it was in years past. We still do experience a bit of it as the aircraft that we're working on and component volumes are a bit less during the summer because the airlines have the aircraft flying, although it's a nice increase year-over-year, I mean, Q1 last year was 7.3%. And obviously, we're forecasting 9% this year.

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### Michael Ciarmoli *Truist Securities, Inc. - Analyst*

Got it. And then just to the organic targets, I guess, I know from it's been a long day and I'm a little bit confused, but you've got the margin expansion, but the EPS CAGR is the same. Presumably you've got some higher interest expense in the short term you're going to delever. I guess I'm just -- I'm trying to reconcile here these organic targets. What's my actual starting point. Because you had one quarter of Triumph, but on an annualized basis. You know, if I pro forma that for '24, I can get -- I can come up with a \$6 number at your midpoint in three years or I can come up with take that \$3.33 and come up with something lower. So how should we interpret these targets?

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

I would interpret as the whole curve has shifted up, meaning we are applying the same organic growth assumptions to a higher base that includes Triumph.

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### Michael Ciarmoli *Truist Securities, Inc. - Analyst*

Okay.

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

We do expect.

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**Michael Ciarmoli Truist Securities, Inc. - Analyst**

So that I could take an annualize, you know, \$280 million that hits closes for '24, give or take at those margins and make my assumptions off of that base?

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

That's right. That's right.

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**Michael Ciarmoli Truist Securities, Inc. - Analyst**

Okay. That helps. And then just last one that I had. Just any other color you USM. I mean, I get it parts are tight. What are you seeing out there in the marketplace. I mean, it seems like this aftermarket with the Boeing and Airbus struggles, continues to benefit, you know, obviously part hard to get any material out there. But any behavioral changes, any color you can give from airline customers or just kind of lay the land out there?

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

Yeah, sure. I'll cover that in a couple of different ways. I mean, first of all, demand remains extremely strong for all that we do from a maintenance perspective, from a component repair perspective, and of course, from a parts perspective. And you're seeing great strength out of the larger carriers like United, maybe a little bit less, but still very strong, but maybe a little bit less of some of the lower cost carriers, as you might expect. But overall, for our large customers, demand is extremely strong.

With -- you started out by asking on USM. USM for all of those reasons is very, very tight right now. We started last quarter really bifurcating that into part sales, individual parts sales as well as whole asset sales. Parts sales, we are -- even though everything is very tight, we are executing very well and getting our hands on the highest demand individual parts. And that drove the 38% growth that we saw in the first quarter on individual parts sales.

Whole assets, mainly engines, are increasingly difficult to come by, and we've seen that market really tighten up in the last few quarters. Because those assets, those whole engines are going on wing as soon as they become available, meaning they're worth more to an operator than they are to guys like us because of the new engine issues, ETF, et cetera. Again, we expect all of that to alleviate, but it's very difficult to predict exactly when that's going to occur.

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**Michael Ciarmoli Truist Securities, Inc. - Analyst**

Okay. Got it. Perfect. I'll jump back in the queue. Thanks guys.

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**Operator**

Bert Subin, Stifel

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**Bert Subin Stifel, Nicolaus & Company, Incorporated - Analyst**

Good afternoon, thank you for the questions.

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

Thank you.

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**Bert Subin Stifel, Nicolaus & Company, Incorporated - Analyst**

John, maybe just to pick up on that last note on the 1Q commentary for 15% to 19% growth, I guess that would imply something a little below, probably around 4.5% organic relative to that 5% to 10% longer-term target. So how do we think about growth this quarter being sort of on the lower end of that next quarter, maybe being below it, what changes? So we go through time to get to the sort of 7.5% plus?

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

Yeah, a few things. Again, you've got a bit of seasonality in this quarter, so that's driving some of it. But as we integrate Triumph's support, as we continue to see supply loosening in the USM market as we ramp up the new distribution deals that we continue to sign. All of those we expect will continue to drive on increasing organic growth.

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**Bert Subin Stifel, Nicolaus & Company, Incorporated - Analyst**

Okay. And maybe I guess just to follow on the distribution side. Growth, there's been really good. I want to say last quarter was 27% this quarter, 16%. You've got the Triumph deal, but I don't believe that's going to start for another several quarters. So in the meantime, we'll just sort of expect double digit growth in distribution? Like what's the -- is there runway to keep growing that double digit for a period of time?

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

Yes. And we see that continuing through this fiscal year.

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**Bert Subin Stifel, Nicolaus & Company, Incorporated - Analyst**

Got it. And then...

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

And again, that's layering on some of the new deals that you just mentioned. But it's also -- if you think about it in terms of same-store sales contracts that we've had in place for a year -- years because of the overall strong demand out there, we continue to see healthy growth out of our mature agreements as well.

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**Bert Subin Stifel, Nicolaus & Company, Incorporated - Analyst**

Okay. And that's, I mean, that's mainly on the commercial side you mentioned potentially going into BG&A. And obviously, you have a government business here. Is there a way to break down sort of where the growth in distributions?

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



Yeah, great question. We did see a nice return to growth in government distribution this quarter that had been on a decline for several quarters, and we did see an inflection point in the last couple of quarters in terms of bookings and now that's translated into sales. So we would expect growth out of government distribution to continue through FY25 based on the backlog that we have.

The focus on BG&A as well as electronics, those are relatively new efforts for us. We're encouraged by some of the early wins that we've had on distribution product lines and as we build out the sales force and build out our presence in the market, we would expect those to be contributors. But I would view that as more significant kind of '26 and beyond. And the growth in '25 will be more commercial and a return to growth in government.

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**Bert Subin Stifel, Nicolaus & Company, Incorporated - Analyst**

Got it. Okay. And then just last one for me, for you Sean. Pretty encouraging to see that the net leverage tick down the pace it did. I think you've talked about getting down sort of closer to 2 times over the next two years, is that still the target? And what should we expect from future deleveraging?

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

Yeah, that's right. Target is to get to that, we had that long-term range to be 1 times to 2 times on the back of the acquisition, focus on getting to that 2 times net leverage. And as you mentioned, as I've talked before kind of that two year timeframe appropriate time line to get there. But we're very pleased with the first quarter being able to take leverage down by [0.3] turns right off the bat.

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**Bert Subin Stifel, Nicolaus & Company, Incorporated - Analyst**

Great. Thanks so much.

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

Thank you, Bert.

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**Operator**

Scott Mikus, Melius Research.

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**Scott Mikus Melius Research LLC - Analyst**

Good evening.

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

Hey Scott.

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**Scott Mikus Melius Research LLC - Analyst**

John, Sean, I wanted to ask on margins at parts supply. There were strong in the quarter, 13.5% in slides mentioned favorable mix and distribution. So I'm just wondering, is there -- should we be using that as a jumping off point for FY25? Or is there a more normalized margin that we should be using?

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

Yeah, it had a mix benefit and part of that mix benefit was on the distribution side as the government sales improved, the margin associated with those tend to be a little bit higher than the commercial side. So that was part of it. So I think that 13.5%, is a bit higher than the past few quarters, which were more in that kind of high 12%. So I think somewhere right in that zip code is a good jumping off point and we'll look to continue to drive, margin as we get incremental sales volume as some of these new product lines ramp up. But somewhere in that zip codes to the right starting point.

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**Scott Mikus Melius Research LLC - Analyst**

Okay. And then recently, we've seen airlines talking about overcapacity, especially in the US domestic market. So I'm just wondering, are you seeing any sort of slowdown whether it be in bookings for your hangars from more US domestic focused carriers or low-cost carriers? And then are they also ordering less parts as well?

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

Yeah. So we have seen a bit of a shift. We're seeing -- continued to see exceptionally strong demand out of the larger carriers, the United, the deltas, et cetera. And those are some of our largest customers. We've seen a little bit of kind of pullback from the lower cost carriers like Southwest. But the larger carriers have been very quick to fill up any demand softness. We're seeing out of those guys. So overall, the environment remains very healthy and again, given the visibility we have in the hangars through the rest of this fiscal year, we expect to be full.

From a parts perspective, it's still very strong across the board, which again, is leading to that constrained supply. If we do see softening and if you do see aircraft come out of service and go to retirement, that would be a very positive thing for us because we would get our hands on assets that we need to fill the demand.

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**Scott Mikus Melius Research LLC - Analyst**

Yeah, I'll stop there. Thank you.

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

Great. Thank you.

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**Operator**

Louie DiPalma, William Blair.

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**Louie DiPalma William Blair & Company L.L.C. - Analyst**

John, Sean, and Dylan, good afternoon.

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

Hey, Louie, how you doing?

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**Louie DiPalma William Blair & Company L.L.C. - Analyst**

Great. You announced the distribution expansion with auto engineering, related to that, how large is your APAC business? And do you have opportunities to add APAC distribution to many of your other OEM partners?

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

So yes. In terms of APAC distribution specifically, I don't have that in front of me right now, we can get to that answer, but it is a large and growing market for us. In the same vein, we also announced an expansion of our agreement with Sumitomo. They've been a great joint venture partner in Japan, and we expect continued growth in that market, in particular.

Having the physical presence with the Triumph facility in Thailand is also going to help it's synergistic with the distribution business. In that a number of OEM partners that we speak to want to have repair capability in region for the parts that we're distributing. So those things go together, it's still early, of course, but we are having some encouraging dialogue about potential further Asian expansion as a result of having that Triumph facility over there now.

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**Louie DiPalma William Blair & Company L.L.C. - Analyst**

Thanks, John. And for Sean, should the operating margin in the second half of the year be higher than the first half? And will the exit rate when taking into account some initial synergies approach, that 10% threshold?

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

Yeah. So one, the operating margin, as we move through this year, we expect will increase, which is similar to this past year as well. But this year we'll have the benefit. We'll start seeing some of the synergies as we move through the fiscal year. And our goal, as you've got the revised medium targets in terms of operating margin. But as we think about this year by the end of it getting towards that 10% is the target.

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**Louie DiPalma William Blair & Company L.L.C. - Analyst**

Great. And one last one on. The government distribution improved, should the return to growth, is that sustainable? And this fiscal year or should we expect that to be lumpy?

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

I would break that down into two parts. One, you've got the government, the overall growth in government is coming from two different areas. One, as you just mentioned, the sales of new parts to the government. We would expect that growth rate to be consistent throughout the year based on the backlog that we have right now.

The other part of the growth that we saw during this quarter came from the increased operational tempo out of two larger programs, most notably the program we have with the State Department, the lost contract, that's a little more difficult to predict because, you know, again, we are moving at the pace of the government and we often don't know the missions that were flying for the government until they actually are flown.

So we feel good about the growth rate out of new parts distribution sales to the government. And we're hopeful that the operational tempo increase that we saw in the fourth quarter will continue throughout this fiscal year on the program side.

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**Louie DiPalma William Blair & Company L.L.C. - Analyst**

Sounds good. Thanks, John, Sean, and Dylan.

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**Operator**

Ken Herbert, RBC.

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

Hi ken.

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**Ken Herbert RBC Capital Markets - Analyst**

Hey, John, how are you?

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

Great. How are you doing?

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**Ken Herbert RBC Capital Markets - Analyst**

Good. Can you just break out within parts supply distribution in particular, what was the growth of commercial versus government if you can provide that in the quarter?

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

Let's see if we have that handy. We may need to get back to you on that specific detail. They were both great.

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**Ken Herbert RBC Capital Markets - Analyst**

Okay. We'll follow up on that. But I guess have you seen any incremental pushback on pricing from customers specifically on the commercial side as it relates to some of your distribution agreements?

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

We have not. And as you're well aware, we obviously buy to the extent that there's OEM price increases. We pass that along. Certainly there are reactions to a certain of those price increases depending on the severity, but it has not impacted the order flow.

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

And then on the distribution growth. Commercial was kind of, you know, low teens growth and government actually had a real nice bounce back and was closer to 20% year-over-year growth.

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**Ken Herbert RBC Capital Markets - Analyst**

Okay. I mean, it looks like the commercial growth was sequentially lower in the fourth quarter than the third quarter. I remember you called that out as part of the third quarter results. Was there anything in particular for that slower growth, maybe tougher comps on the commercial side or anything in particular, we should keep in mind?

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

No, I won't point to anything in particular. I mean, you do see ebbs and flows in order volume that largely depends on when we receive material from the our OEM partners. And as you know, the supply chains are still quite dynamic right now, but I won't point to anything in particular.

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**Ken Herbert RBC Capital Markets - Analyst**

Okay, great. And within integrated solutions, was there anything one-time in the quarter that -- I mean, it sounds like there was maybe some issues with the State Department contract that negatively impacted margins there. Does that a one quarter event? Or how should we think about sort of the jumping off point for margins in that business into fiscal '25?

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

Yeah, there were no significant one-time items as it relates to margin in the quarter and integrated solutions. The mix within government was some of the sales mix was towards some of the slightly lower margin programs, but there wasn't anything kind of one-time associated with that.

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**Ken Herbert RBC Capital Markets - Analyst**

So low single digits, maybe the right way to think about segment margins for that business?

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

Well, I think in the near term, yes, but as Trax ramps, that will be accretive to the margin, and will move into this fiscal year, that will be accretive to the margin portfolio and then in the programs piece, kind of that zip code that you mentioned is about the right place for margin expectations.

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**Ken Herbert RBC Capital Markets - Analyst**

Okay, perfect. I'll stop there. Thanks, Sean, I pass it back.

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

Thanks, Ken.

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**Operator**

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

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

Great. Well, thank you, everybody, for your time and attention. Again, we're extremely proud of the results. We're excited about FY25, and we look forward to speaking with you again in September. Thank you.

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**Operator**

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

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