AAR CORP
Form DEF 14A
September 01, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934 (Amendment No.)

Filed by the Registrant x
Filed by a Party other than the Registrant o
Check the appropriate box:

o	Preliminary Proxy Statement
o	**Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
x	Definitive Proxy Statement
o	Definitive Additional Materials
o	Soliciting Material Pursuant to §240.14a-12

AAR CORP.
(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x	No fee required.		
o	Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.		
	(1)	Title of each class of securities to which transaction applies:	
	(2)	Aggregate number of securities to which transaction applies:	
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o	Fee paid previously with preliminary materials.		
o	Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.		
	(1)	Amount Previously Paid:	
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One AAR Place
1100 N. Wood Dale Road
Wood Dale, IL 60191

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
TO BE HELD ON WEDNESDAY, OCTOBER 19, 2005

The Annual Meeting of Stockholders of AAR CORP. for the year 2005 will be held at AAR CORP. s headquarters, One AAR Place, 1100 North Wood Dale Road, Wood Dale, Illinois, on Wednesday, October 19, 2005, at 9:00 A.M. (Chicago time). At the meeting, stockholders will be asked to:

1. Elect two Class III directors to serve until the 2008 Annual Meeting of Stockholders;

2. Ratify the appointment of KPMG LLP as the independent registered public accounting firm for the fiscal year ending May 31, 2006;

3. Approve an amendment to the AAR CORP. Stock Benefit Plan to permit awards of restricted stock to non-employee directors; and

4. Transact any other business that may properly come before the 2005 Annual Meeting.

By Order of the Board of Directors
Howard A. Pulsifer
Secretary

September 1, 2005

YOUR VOTE IS IMPORTANT

PLEASE DATE AND SIGN THE ENCLOSED PROXY AND RETURN IT IN THE ENCLOSED STAMPED, ADDRESSED ENVELOPE, OR SUBMIT YOUR PROXY BY TELEPHONE OR THE INTERNET SO THAT IF YOU ARE UNABLE TO ATTEND THE MEETING, YOUR SHARES MAY NEVERTHELESS BE VOTED. NO POSTAGE IS REQUIRED FOR MAILING IN THE UNITED STATES.

2005 Annual Meeting of Stockholders

PROXY STATEMENT

One AAR Place
1100 N. Wood Dale Road
Wood Dale, Illinois 60191

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One AAR Place
1100 N. Wood Dale Road
Wood Dale, Illinois 60191

PROXY STATEMENT

ANNUAL MEETING OF STOCKHOLDERS
October 19, 2005

I. GENERAL

This Proxy Statement and the enclosed proxy card were mailed to stockholders on or about September 1, 2005, in connection with the solicitation of proxies by the Board of Directors of the Company to be used at the 2005 Annual Meeting (Annual Meeting).

If you are a stockholder of record (i.e., you hold your shares in your own name rather than through a broker, bank or other nominee) on August 22, 2005, the Company s record date, you may vote your shares by completing, signing, dating and returning your proxy card in the postage-paid envelope provided, or you may vote in person at the Annual Meeting.

You are encouraged to vote either by telephone or the Internet. This will eliminate the need to sign, date and return your proxy card. To vote by telephone or the Internet enter the control number assigned to you and imprinted on your proxy card accompanying this Proxy Statement. You can vote by telephone and Internet 24 hours a day, seven days a week until the day prior to the Annual Meeting. If you vote by telephone or the Internet, please do not return your proxy card.

- **To vote by telephone:**

Ø **using a touch-tone phone, call 1-877-PRX-VOTE (1-877-779-8683) toll-free and follow the voice prompts**

- **To vote by Internet:**

Ø **Log onto the Internet website at http://www.eproxyvote.com/air and enter your voter control number on your proxy card and mark the appropriate boxes to enter voting instructions**

If you are a street-name stockholder (i.e., you hold your shares through a broker, bank or other nominee), you are considered a beneficial owner of the stock. To vote those shares, you must give voting instructions to your broker, bank or other intermediary who is the nominee holder of your shares. Brokers, banks and other nominee holders have been asked to obtain voting instructions from their beneficial owners. Proxies submitted by nominee holders on behalf of beneficial owners will count toward a quorum and will be voted as instructed by the nominee holder. You will receive additional instructions from your broker, bank or other nominee explaining how you may vote your shares held in street name.

You may revoke your vote at any time before your proxy is exercised, but only by (i) voting in person at the Annual Meeting, (ii) submitting another proxy by telephone or the Internet, or (iii) delivering a later dated, signed proxy to the Secretary of the Company.

Proxies will be voted in accordance with instructions on the proxy. If no instructions are specified, the proxy will be voted **FOR** the election of the nominees for Class III director designated by the Board, **FOR** the ratification of KPMG LLP as the independent registered public accounting firm, **For** the amendment to the AAR Corp. Stock Benefit Plan, and upon any other matter that may properly come before the Annual Meeting in the discretion and best judgment of the named proxy holders. If any director nominee becomes unavailable for election for any reason prior to the Annual Meeting vote, the Board may reduce the number of directors to be elected or substitute another person as nominee, and the named proxy holders will vote for the substitute nominee.

The cost of soliciting proxies will be paid by the Company. The Company has engaged D. F. King & Co., 48 Wall Street, New York, New York, to assist the Company in soliciting proxies at a total estimated cost of $8,000, plus reasonable out-of-pocket expenses. D. F. King & Co. may solicit proxies by mail, telephone, facsimile, e-mail, or in person. Certain officers, directors and employees of the Company may also solicit proxies.

II. RECORD DATE AND VOTING AT THE ANNUAL MEETING

If you owned common stock of the Company (Common Stock) outstanding at the close of business on the record date, August 22, 2005, you may vote at the Annual Meeting. On that date, 32,534,611 shares of Common Stock were outstanding. You will have one vote on each matter to be voted on for each share you owned on the record date. You cannot vote your shares unless you are present at the Annual Meeting in person or by proxy. A majority of the outstanding shares of Common Stock entitled to vote, present in person or represented by proxy at the Annual Meeting, will constitute a quorum. All votes cast in person or by proxy will be tabulated by the inspectors of election appointed for the Annual Meeting. The inspectors of election will treat directions to withhold authority, abstentions and broker non-votes (i.e., where a nominee holding shares for a beneficial owner has not received voting instructions from the beneficial owner with respect to a particular matter and such nominee does not possess or choose to exercise his discretionary authority with respect to such matter) as shares that are present and entitled to vote for purposes of determining a quorum. Directions to withhold authority will have no effect on the election of directors, because directors are elected by a plurality of votes cast. Abstentions and broker non-votes will be disregarded for purposes of determining whether a matter has been approved, because they are not considered votes cast. It is not anticipated that there will be any broker non-votes on the election of directors since brokers will have discretion to vote on this proposal.

III. CORPORATE GOVERNANCE INFORMATION

The Company has an ongoing commitment to good governance and business practices. We regularly review our policies and procedures, giving consideration to developments in the area of corporate governance. We comply with all applicable Securities and Exchange Commission (SEC) rules and regulations and New York Stock Exchange (NYSE) listing rules and have adopted additional corporate governance practices that we believe are in the best interests of the Company and the stockholders.

The following information about the Company s corporate governance practices is available on the Company s web site (www.aarcorp.com/investor relations/corporate governance). Hard copies are also available to any stockholder upon written request to the Corporate Secretary. The web site display includes the Company s:

- Corporate Governance Guidelines
- Categorical Standards and Policy for Determining Director Independence
- Director Nominating Process and Selection Guidelines
- Code of Business Ethics and Conduct
- Audit Committee Charter
- Compensation Committee Charter

- Nomination and Governance Committee Charter
- Executive Committee Charter
- Proxy Statement for the 2005 Annual Meeting of Stockholders and Fiscal Year 2005 Annual Report

In addition, all of the foregoing information is available in print to any stockholder upon written request to the Corporate Secretary at the Company s address listed on the first page of this proxy statement. The Company s *Code of Business Ethics and Conduct* adopted by the Board of Directors applies to all employees, officers and directors of the Company, including the Chief Executive Officer, the Chief Financial Officer and the Chief Accounting Officer and Controller. Employees are encouraged to report any conduct that they believe in good faith to be in violation of the Code of Business Ethics and Conduct. Amendments to the Code of Business Ethics and Conduct and any waivers from the Code granted by the Board to directors or executive officers will be filed with the SEC in accordance with applicable rules and regulations or will be posted on the Company s web site.

The Company maintains an Ethics Assist Line through a third-party provider to receive confidential complaints, information, suggestions or recommendations, anonymously or otherwise, concerning the Company, its officers, directors and employees, policies, procedures, employment and business practices, accounting or audit matters, financial reporting or compliance with other Company policies or applicable regulatory or legal requirements. The Ethics Assist Line is toll-free and permits callers, at their election, to identify themselves or remain anonymous. The Ethics Assist Line can be accessed by dialing 1-800-418-6423 (x227) or via e-mail to confide2sv@securityvoice.com.

Information concerning insider transactions in the Company s securities (SEC Section 16(a) Forms 3, 4 and 5) is also available on the Company s web site (www.aarcorp.com/investor relations/insider trading; to view actual Forms 3, 4 or 5, click on the Insider Trading link to the SEC filings).

Additional information concerning the structure of the Board of Directors and Committees of the Board of Directors is provided in Section V below.

IV. SECURITY OWNERSHIP OF MANAGEMENT AND OTHERS

The following tables show the shares of Common Stock beneficially owned, as of July 31, 2005, by (i) each current director and nominee for election to the Board, (ii) each executive officer named in the Summary Compensation Table, (iii) all directors and executive officers of the Company as a group, and (iv) each beneficial owner of more than 5% of the outstanding shares of Common Stock. Except as noted, the nature of beneficial ownership for shares shown in the tables is sole voting and/or investment power.

Security Ownership of Management

Name	Shares Beneficially Owned[1]		Percent of Shares Outstanding if greater than 1%
Michael R. Boyce	0		
James G. Brocksmith, Jr.	12,625		
James J. Clark	145,474		
Ira A. Eichner	527,891	2	1.6
Ronald R. Fogleman	12,625		
James E. Goodwin	12,125		
Mark McDonald	87,112	3	
Howard A. Pulsifer	185,030		
Timothy J. Romenesko	234,104		
David P. Storch	2,039,776	4	6.3
Marc J. Walfish	12,625		
Ronald B. Woodard	875		
All directors and executive officers as a group	3,270,262	1,2,3,4	10.1

1 Includes the following shares of the identified person that may be acquired within sixty days of July 31, 2005 through the exercise of stock options: Mr. Brocksmith, 12,625 shares; Mr. Clark, 100,446 shares; Mr. Eichner, 155,511 shares; Mr. Fogleman, 12,625 shares; Mr. Goodwin, 10,125 shares; Mr. McDonald, 37,234 shares; Mr. Pulsifer, 112,526 shares; Mr. Romenesko, 149,278 shares; Mr. Storch, 1,516,542 shares; Mr. Walfish, 7,625 shares; and Mr. Woodard, 875 shares; and all directors and officers as a group, 2,115,412 shares.

2 Does not include 75,000 shares in which Mr. Eichner may be deemed to own a beneficial interest, but as to which Mr. Eichner disclaims beneficial ownership.

3 Includes 5,600 shares beneficially owned by his minor children, as to which Mr. McDonald disclaims beneficial ownership.

4 Includes 26,223 shares beneficially owned by Mr. Storch s wife (18,810 shares) and minor children (7,413 shares), as to which Mr. Storch disclaims beneficial ownership.

4

Security Ownership of Certain Beneficial Owners

Name and Address of Beneficial Owner	Shares Beneficially Owned	Percent of Shares Outstanding
Dimensional Fund Advisors Inc. 1299 Ocean Avenue Santa Monica, CA 90401	2,659,369 1	8.25 %
FMR Corp. 82 Devonshire Street Boston, MA 02109	4,832,300 2	14.986 %
Putnam Investments One Post Office Square Boston, MA 02109	2,111,100 3	6.5 %
State Street Research & Management Company One Financial Center Boston, MA 02111-2690	1,953,320 4	6 %

1 Based on a Schedule 13G filing, the reporting person disclosed beneficial ownership with respect to the shares as follows:

(i)	sole voting power:	2,659,369
(ii)	shared voting power:	0
(iii)	sole investment power:	2,659,369
(iv)	shared investment power:	0

2 Based on a Schedule 13G filing, the reporting person disclosed beneficial ownership with respect to the shares as follows:

(i)	sole voting power:	676,100
(ii)	shared voting power:	0
(iii)	sole investment power:	4,832,300
(iv)	shared investment power:	0

3 Based on a Schedule 13G filing, the reporting person disclosed beneficial ownership with respect to the shares as follows:

(i)	sole voting power:	0
(ii)	shared voting power:	597,600
(iii)	sole investment power:	0
(iv)	shared investment power:	2,111,100

4 Based on a Schedule 13G filing, the reporting person disclosed beneficial ownership with respect to the shares as follows:

(i)	sole voting power:	1,953,320
(ii)	shared voting power:	0
(iii)	sole investment power:	1,953,320
(iv)	shared investment power:	0

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Based solely upon a review of SEC Forms 3, 4 and 5 and upon related written representations furnished to the Company with respect to its most recent fiscal year, each person who, at any time during the fiscal year, was a director, officer or beneficial owner of more than ten percent of the Common Stock of the Company filed on a timely basis all reports required by Section 16(a) of the Securities Exchange Act of 1934, as amended, during the most recent fiscal year.

V. BOARD OF DIRECTORS

The Restated Certificate of Incorporation and By-Laws of the Company provide that the Board shall consist of between three and fifteen directors, with the exact number of directors to be set from time to time by the Board. The number of directors is presently set at eight, to be reduced to seven effective October 19, 2005 when one current director, Ira A. Eichner, will retire as a Class III director. The members of the Board are divided into three classes: Class I (three directors), Class II (two directors) and Class III (two directors). One class is elected each year for a three-year term.

A majority of the members of the Board of Directors must be independent directors under the criteria established by the Board and under applicable NYSE rules. To be independent, a director may not have a direct or indirect material relationship with the Company that would impair or inhibit a director s exercise of independent judgment on behalf of the Company and its stockholders. The Nominating and Governance Committee and the Board of Directors review each director annually and make a determination concerning independence after consideration of all known facts and circumstances. As permitted by the NYSE rules, the Board has established categorical standards to assist it in determining director independence. The Company s categorical standards include all of the elements of the SEC rules and the NYSE company listing rules with respect to director independence and are published on the Company s web site. Based on these categorical standards, the Board, at its meeting in July, 2005, determined whether any director has a material relationship with the Company that would impair the director s independence. Having considered all relevant facts and information available and the recommendations of the Nominating and Governance Committee based on their review, the Board affirmatively determined that all directors, except Ira A. Eichner and David P. Storch, are independent directors.

Independent directors of the Board meet in executive session without management as part of each regular session and otherwise when circumstances deem it advisable or necessary. The Chairman of the Nominating and Governance Committee presides at the executive session of independent directors.

Stockholders may communicate with the Board, independent directors as a group, or any individual director by mail addressed to: AAR CORP., Attention: Independent Directors, or the name of an individual director, C/O Corporate Secretary, AAR CORP., 1100 N. Wood Dale Road, Wood Dale, Illinois 60191.

All members of the Company s Board of Directors attended the Company s 2004 Annual Meeting of Stockholders.

During the fiscal year ended May 31, 2005 (Fiscal 2005), the Board held four meetings. All of the incumbent directors attended at least 91% of the aggregate meetings of the Board and of the committees on which they served during Fiscal 2005.

BOARD COMMITTEES

The Board has an Audit Committee, a Compensation Committee, a Nominating and Governance Committee, and an Executive Committee.

Audit Committee

The Audit Committee is comprised entirely of independent directors qualified to serve on the Audit Committee under applicable SEC regulations, NYSE rules and the Company s Categorical Standards and Policy for Determining Director Independence. Its members are James E. Goodwin (Chairman), James G. Brocksmith, Jr. and Marc J. Walfish (during Fiscal 2005, Joel D. Spungin, an independent director and audit committee financial expert , now deceased, also served on the Audit Committee). The Board of Directors has determined that each member of the Audit Committee is an audit committee financial expert , as defined by the SEC.

The Audit Committee acts pursuant to its written charter adopted by the Board of Directors. The charter was last reviewed and approved by the Audit Committee and the Board of Directors at their July, 2005 meetings. The full text of the Audit Committee charter appears on the Company s web site and is attached to this Proxy Statement as Appendix 1. The Audit Committee performs the functions described in its charter and, among other things, approves and engages the independent auditors who audit the Company s consolidated financial statements, pre-approves all non-audit/audit related services furnished by the independent auditors, maintains communication between the Board and the independent auditors, monitors the qualifications, independence and performance of the independent auditors, has oversight of and reviews the Company s financial reporting process and practices, has oversight of and reviews the quality and adequacy of financial accounting controls, disclosure controls and the organization and performance of the Company s internal systems of audit, reviews the scope and results of audits, and meets with the independent auditors and internal auditors without members of management present. The Audit Committee held eight meetings during Fiscal 2005. The Report of the Audit Committee for Fiscal Year 2005 ended May 31, 2005 appears on page 23.

Compensation Committee

The Compensation Committee is comprised entirely of independent directors as defined under applicable NYSE rules and the Company s Categorical Standards and Policy for Determining Director Independence. Its members are James G. Brocksmith, Jr. (Chairman), Ronald R. Fogleman, and Ronald B. Woodard (during Fiscal Year 2005, Joel D. Spungin, now deceased, also served on the Compensation Committee). The Compensation Committee performs the functions described in its written charter. The full text of the Compensation Committee charter appears on the Company web site. Among other things, the Compensation Committee reviews and approves compensation policies and practices for all elected corporate officers, fixes the compensation of the President and Chief Executive Officer, evaluates the Chief Executive Officer s performance, and administers the Chief Executive Officer s long-term incentive program, the annual incentive compensation programs for other officers, and the AAR CORP. Stock Benefit Plan. The Compensation Committee also oversees administration of certain other employee benefit, savings and retirement plans. The Compensation Committee held four meetings during Fiscal 2005. The Compensation Committee Report on Executive Compensation appears on page 12.

Nominating and Governance Committee

The Nominating and Governance Committee is comprised entirely of independent directors as defined under applicable NYSE rules and the Company s Categorical Standards and Policy for Determining Director Independence. Its members are Ronald R. Fogleman (Chairman), James E. Goodwin and Marc J. Walfish. The Nominating and Governance Committee is responsible for both nominating and governance functions as described in its charter. The full text of the Nominating and Governance Committee charter appears on the Company s web site. Among other things, the Nominating and Governance Committee oversees the composition, structure and evaluation of the Board and its committees, develops and recommends corporate governance guidelines for Board approval, monitors and screens directors for independence and recommends to the Board qualified candidates for election as directors and to serve on Board committees. In seeking qualified candidates, the Nominating and Governance Committee obtains referrals from management, other directors and business and community leaders, and may retain the services of a consultant to assist in identifying candidates. As discussed in its charter, the Nominating and Governance Committee seeks candidates that complement the Board as a whole and that collectively are strong and diverse in knowledge, skills, experience, and background. When selecting nominees, including those proposed by stockholders, the Committee looks for candidates who are independent and have a high level of integrity and professional and personal ethics and values, as well as demonstrated business acumen, leadership and policy making experience or special technical skills, irrespective of gender or ethnicity, as well as other factors the Committee deems appropriate. The Committee has full discretion in considering its nominations to the Board. The Company s Director Nominating Process and Selection Guidelines appear on the Company s web site. The Nominating and Governance Committee will consider director candidates recommended by stockholders. Stockholders may submit a proposed nomination to the Nominating and Governance Committee for consideration with respect to the Annual Meeting of Stockholders for the year 2006 by writing to the Secretary, AAR CORP., One AAR Place, 1100 N. Wood Dale Road, Wood Dale, Illinois 60191. To be considered, proposed nominations must be received prior to April 15, 2006, must state the reasons for the proposed nomination and contain the full name and address of each proposed nominee, as well as a brief biographical history setting forth past and present directorships, employment and occupations, and any other qualifications. Proposed nominations must also include a statement indicating that the proposed nominees have consented to being named in the proxy statement and to serve if elected. The Nominating and Governance Committee held three meetings during Fiscal 2005.

Executive Committee

The Executive Committee is comprised of Ira A. Eichner (Chairman), David P. Storch, James E. Goodwin, and Marc J. Walfish (effective October 19, 2005, Mr. Eichner will retire as a Director of the Company and Mr. David P. Storch will become Chairman of the Executive Committee). Mr. Goodwin and Mr. Walfish are each independent directors as defined by applicable NYSE rules and the Company s Categorical Standards and Policy for Determining Director Independence. The Executive Committee acts pursuant to its written charter adopted by the Board of Directors and is authorized to meet between meetings of the Board of Directors and exercise certain powers of the Board with respect to urgent matters or other matters referred to it by the Board for deliberation or action, subject to limitations imposed by the Committee s charter, the Board, applicable law and the Company s By-Laws. The full text of the Executive Committee charter appears on the Company s web site. The Executive Committee did not hold any meetings during Fiscal 2005.

DIRECTORS COMPENSATION

Each director who is not an officer or employee of the Company or any subsidiary (Eligible Director) receives an annual retainer of $35,000, a fee of $2,500 for attendance at each meeting of the Board or of any Board committee attended in person ($1,250 per meeting for telephonic Board and Committee meetings), plus reimbursement of expenses. The Chairman of the Board and each committee chairman receive an additional $5,000 retainer. Each Eligible Director may elect to defer receipt of the annual retainer and meeting fees pursuant to the Company s Nonemployee Directors Deferred Compensation Plan. Deferred retainer fees are converted into stock units equivalent to shares of Common Stock, and deferred meeting fees are credited with interest quarterly based on the 10-year United States Treasury Bond rate. Distributions under the plan occur in cash or equivalent value Common Stock, at the participant s election, upon termination of service on the Board and on the happening of certain other events, as specified in the plan.

In addition, each Eligible Director, upon being elected a director, receives term life insurance coverage of $200,000, and is eligible to receive discretionary stock option grants and restricted stock awards (subject to stockholder approval of Proposal 3 described on page 26 below) from time to time under the AAR CORP. Stock Benefit Plan, as may be determined by the Compensation Committee. Historically, non-employee directors have received an annual stock option grant, however, commencing in Fiscal 2006 directors will receive restricted stock awards (subject to stockholder approval of Proposal 3 described on page 26 below) in lieu of stock option grants. Typically, such options expire ten years from the date of grant and become exercisable in 25% increments on each anniversary grant date at the closing NYSE price on the date of grant, and non-employee directors restricted stock awards vest pro rata over a three year period. In Fiscal 2005 non-employee directors received a stock option for 3,500 shares. In Fiscal 2006, the Compensation Committee reviewed total director compensation based on peer group benchmarks. The review indicated that the Company s non-employee director equity compensation level was below the peer group median. To bring non-employee director equity compensation closer to midway between the peer group median and 75th percentile, on the Compensation Committee s recommendation, the Board determined that annual non-employee director equity compensation should be increased to approximately $40,000 in value. The Board further determined, on the recommendation of the Compensation Committee, that such value should be achieved using restricted stock rather than stock options in part because restricted stock results in less stockholder dilution than stock options of an equivalent value, and restricted stock can be more accurately valued than can stock options. Accordingly, for Fiscal 2006, the Compensation Committee approved an annual 2,500 share restricted stock grant for each non-employee director, having a grant date value of $40,750, subject to stockholder approval of Proposal 3 described on page 26 below. Under the Company s stock ownership guidelines for directors, each director is expected to own a minimum of 10,000 shares of Company common stock while serving as a director, such ownership to be achieved prior to July 15, 2009 or within four (4) years of becoming a director, whichever is later.

The AAR CORP. Directors Retirement Plan was terminated effective April 10, 2001. Any director who was a director on the plan s effective date of termination or a retired director then receiving benefits under the plan will continue to be eligible to receive benefits pursuant to the terms of the plan as the plan was in effect and applicable to such participant on the earlier of the date of plan termination or date of retirement. Benefits are paid upon reaching age 65 and retirement from the Board if such director has completed at least five years of service as a director. Benefits are paid quarterly in cash in an amount equal to 25% of the annual retainer then currently payable to directors of the Company and are paid for a period equal to the total number of years of service as a director to a maximum of ten years or until death. Continuing liabilities under the plan are unfunded. As of May 31, 2005, five former directors are receiving retirement benefits under the plan, one former director is eligible to receive benefits under the plan upon reaching age 65, and two current directors are eligible to receive benefits under the plan at age 65 and retirement from the Board.

Directors who are officers or employees of the Company or any subsidiary receive no additional compensation for service on the Board or any of its committees.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Mr. Eichner, a director of the Company and Chairman of the Board, provides consulting services to the Company pursuant to a consulting agreement that expires on May 31, 2006, under which he receives a quarterly consulting fee in the amount of $25,000. Mr. Eichner will be retiring from the Board of Directors at the conclusion of his current term on October 19, 2005. During Fiscal 2005, Mr. Eichner received $100,000 in consulting fees.

VI. PROPOSAL 1
ELECTION OF DIRECTORS

The Board of Directors is presently divided into three classes, each having three-year terms that expire in successive years. The Board of Directors has nominated two directors to be elected in Class III at the Annual Meeting, each to serve a three-year term expiring at the 2008 Annual Meeting or until the individual is succeeded by another qualified director who has been duly elected.

The nominees for Director in Class III this year are **Ronald R. Fogleman and Ronald B. Woodard**.

Information about the nominees, and continuing directors whose terms expire in future years, is set forth in Section VII below beginning on page 11.

Each nominee is currently serving as a director of the Company and has been determined by the Board to be independent within the meaning of NYSE rules and the Company s Categorical Standards and Policy for Determining Director Independence. The Board expects each nominee to serve if elected as a director. Under Delaware law and the Company s By-Laws, the nominees for director who individually receive the greatest number of votes shall be elected directors of the Company.

THE BOARD OF DIRECTORS RECOMMENDS THAT STOCKHOLDERS VOTE FOR ALL NOMINEES

VII. INFORMATION ABOUT THE NOMINEES AND CONTINUING DIRECTORS

Information about the nominees and continuing directors whose terms expire in future years is set forth below:

	Director Since
NOMINEES FOR TERMS EXPIRING IN 2008	
Class III Directors whose terms expire at the 2005 Annual Meeting:	
RONALD R. FOGLEMAN, 63: Since May, 2004, non-executive Chairman of World Airways, Inc. Since 1997, President and Chief Operating Officer of B Bar J Cattle Company and President and Chief Operating Officer of Durango Aerospace Incorporated, an international aviation consulting firm, and member of NASA Advisory Council and Defense Policy Board. From 1994 to 1997, General, Chief of Staff, Headquarters United States Air Force, Washington, D.C. Other directorships: Alliant Techsystems, Inc.; Mesa Air Group Inc.; World Airways Inc.	2001
RONALD B. WOODARD, 62: Since 2003, Chairman of MagnaDrive, Inc., an industrial torque transfer equipment company, which he co-founded following his retirement from The Boeing Company after 32 years. From 1995 to 1998, President of the Boeing Commercial Airplane Group. From 1991 to 1994, Vice President and General Manager of the Renton Division of Boeing Commercial Aircraft. From 1987 to 1991, President of deHavilland Aircraft. Prior to that, Vice President and General Manager of the Materiel Division of Boeing Commercial Aircraft, and various other management positions. Other directorships: Coinstar Inc.; Continental Airlines, Inc.	2004
CONTINUING DIRECTORS:	
Class I Directors whose terms expire at the 2006 Annual Meeting:	
JAMES G. BROCKSMITH, JR., 64: Since 1996, an independent business consultant. From 1990 to 1996, Deputy Chairman, and Chief Operating Officer of KPMG Peat Marwick, where he retired after 31 years. Other directorships: Alberto-Culver Company; Nationwide Financial Services, Inc.; Sempra Energy.	2001
DAVID P. STORCH, 52: Since 1996, President and Chief Executive Officer of AAR. From 1989 to 1996, President and Chief Operating Officer of AAR. From 1988 to 1989, Vice President of AAR. Mr. Storch is Mr. Eichner s son-in-law. Other directorships: None	1989
MICHAEL R. BOYCE, 57: Since 2005, Chairman and Chief Executive Officer of PQ Corporation, an industrial chemicals company. Since 1998, Chairman and Chief Executive Officer of Peak Investments. From 1990 to 1998, President and Chief Operating Officer of Harris Chemical Group, Inc. Other directorships: None	2005
CONTINUING DIRECTORS:	
Class II Directors whose terms expire at the 2007 Annual Meeting:	
JAMES E. GOODWIN, 61: Since 2001, an independent business consultant. From 1999 to 2001, Chairman and Chief Executive Officer of UAL, Inc. and United Airlines, Inc., where he retired after 34 years. From 1998 to 1999, President and Chief Operating Officer of United Airlines, Inc. From 1992 to 1998, Senior Vice President of United Airlines, Inc. Other directorships: Labe Bank; DBS Communications Inc.	2002
MARC J. WALFISH, 52: Founded Merit Capital Partners in 2003. From 1991 to 2003, William Blair Mezzanine Capital Partners. From 1978 to 1991, Prudential Capital Corporation, most recently as Senior Vice President. Other directorships: None	2003

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VIII. EXECUTIVE COMPENSATION AND OTHER INFORMATION

COMPENSATION COMMITTEE S REPORT ON EXECUTIVE COMPENSATION

General

The Company s executive compensation program is structured and administered by the Compensation Committee of the Board of Directors. The Compensation Committee is comprised of the three individuals listed below, each of whom (i) has been determined by the Board of Directors to be an independent director of the Company under applicable NYSE rules and the Company s Categorical Standards and Policy for Determining Director Independence, (ii) is a non-employee director for purposes of Rule 16b-3 of the Exchange Act, and (iii) is an outside director for purposes of Section 162(m) of the Internal Revenue Code.

The Committee meets at scheduled times during the year and reports regularly to the Board on Committee actions and recommendations. In carrying out its responsibilities and duties, the Committee has direct access to outside advisers, independent compensation consultants and others.

The compensation program for executives is designed to enable the Company to attract, motivate and retain talented executives capable of achieving strategic business initiatives, producing outstanding business performance and shareholder value, and to reward them for their achievement. The Company strives to provide an aggregate compensation opportunity that is competitive with prevailing practices and reflects total compensation that is justified by individual experience, performance and business results. A principle compensation guideline of the Committee is that there be a strong link between pay and performance both at the Company level and individual level.

The Committee intends that the executive compensation program should complement the Company s short-term and long-term business objectives and focus executives efforts on fulfilling these objectives. The program consists of three elements: (i) base salaries which are generally set between the median and third quartile salary level of comparable positions in similar companies, adjusted up or down to reflect individual responsibilities, performance and other relevant factors; (ii) annual variable incentive opportunities paid in cash based on individual contribution and performance; and (iii) long-term incentive opportunities, in the form of stock options and restricted stock awards.

Total compensation opportunities for each executive are intended to be competitive with those offered by other companies competing for talent in the Company s employment market. In designing and administering the individual elements of the executive compensation program for each executive, the Compensation Committee strives to balance short- and long-term incentive objectives and employ prudent judgment in establishing base salary levels and performance criteria, evaluating performance and determining actual incentive payments. To ensure competitiveness and reasonableness of the Compensation Committee s compensation decisions, independent compensation consulting firms are retained periodically to advise the Compensation Committee in connection with both the design and implementation of the various elements of the program and the level of individual executive participation. The Company uses competitive compensation analyses by independent consultants to ensure that the President and Chief Executive Officer s and other executive officers base salaries and total compensation opportunities (not actual pay) are at an appropriate competitive level relative to compensation for such positions at other companies in the relevant employment market. Generally, as an executive s level of responsibility increases, a greater percentage of total compensation opportunity is based on performance, and the mix of total compensation shifts toward stock, thereby aligning the long-term interest of senior executives with those of stockholders.

Base Salaries

Base salary levels of all elected corporate officers, including the President and Chief Executive Officer, are reviewed annually by the Compensation Committee and may be adjusted depending upon the executive s qualifications, responsibilities, assessed performance contribution, tenure in the Company and in the position held, and competitive salary considerations relative to similar positions at other companies competing for talent in the Company s employment market. In Fiscal 2002, the Company implemented a sliding scale base salary reduction program for all employees, including the named executive officers, as part of a company-wide cost reduction effort. In Fiscal 2003, base salaries were fully reinstated for employees generally, but were only partially reinstated for certain senior executives. The President and Chief Executive Officer and other executive officers named in the Summary Compensation Table received no salary increases in Fiscal 2004, with the exception of one named executive officer who assumed new responsibilities during the period. In Fiscal 2005, the base salaries of most employees, including the named executive officers, were increased effective June 1, 2004 by the greater of three percent or an amount that would restore their respective base salaries to pre-October 1, 2001 salary levels. Effective June 1, 2005, the Compensation Committee approved a 3% merit increase pool for all employees, including named executive officers, with individual increases based on individual performance after completion of written performance reviews.

Annual Incentive Opportunities

The President and Chief Executive Officer has an annual performance-based cash incentive bonus opportunity, pursuant to his employment agreement, of up to 150% of his base salary under the Company s stockholder- approved AAR CORP. Section 162(m) Performance-Based Annual Cash Bonus Program (AAR s 162(m) Program). The annual incentive bonus opportunity for other executive positions varies depending on their position and responsibility level.

Under AAR s 162(m) Program, each fiscal year the Compensation Committee establishes specific performance goals intended to meet the requirements of Section 162(m) of the Internal Revenue Code (IRC), for the President and Chief Executive Officer of the Company and certain other executive officers of the Company. These goals focus on two categories: income and balance sheet management. The importance and weighting of these two categories is established each year by the Compensation Committee. Under the category of income, the goals include one or several of the following: pre-tax income, earnings per share and net income. Under the category of balance sheet management, the goals include one or several of the following criteria: shareholder equity, long-term debt to capital ratio, investment rating, debt coverage, cash flow and return on invested capital. The President and Chief Executive Officer is eligible to earn up to 100% of his base salary for meeting target goals and up to an additional 50% of base salary for exceeding target goals. The amount actually earned depends on each participant s position, bonus opportunity and actual performance versus the pre-established goals.

Long-Term Incentive Opportunities

To reward and retain employees in a manner that best aligns employees interests with stockholder interests, the Company implemented the stockholder-approved AAR CORP. Stock Benefit Plan (Stock Benefit Plan). The long-term incentive program consists of stock options or restricted stock/performance restricted stock awards, or any combination thereof, granted under the Stock Benefit Plan, in the discretion of the Compensation Committee. The Stock Benefit Plan also provides for the use of stock appreciation units; however, to date, none have been granted. The specific terms of any stock option or restricted stock grants are determined by the Compensation Committee prior to the issuance of grants, subject to the provisions of the Stock Benefit Plan.

Stock option awards typically expire ten years from the date of grant or earlier upon termination of employment, become exercisable in equal increments over a period of three to five years on successive grant anniversary dates at fair market value based on the NYSE closing stock price on the date of grant or, in some instances, upon meeting certain share price performance criteria, and have been accompanied by reload features (In 2005 the Board amended the Plan to eliminate the reload feature in future grants). Typically, stock option grants vest in 20% increments ratably on the grant date anniversary (Fiscal Year 2003 option grants had a dual vesting schedule that also provided an opportunity for accelerated vesting based on the Company s rolling 20-day average New York Stock Exchange stock price appreciating above the grant price beyond certain specified threshold values on a sliding scale). Restrictions imposed on restricted stock awards vary and are designed, among other things, to encourage executives to stay with the Company and to maintain a focus on long-term objectives of the Company. Restricted stock grants typically vest over periods of three to ten years from grant date and may be performance-based with vesting to occur over periods of three to six years after being earned. Typically, stock option and restricted stock grants are subject to forfeiture if the employee terminates employment for any reason other than death, retirement or disability or the Company terminates employment for cause, during the grant cycle. The award recipient receives dividends on the restricted shares and also has the right to vote the restricted shares.

Generally, when determining stock option and restricted stock awards, the Committee considers the recipient s position and responsibilities in the Company, performance and contributions made during the preceding year, capabilities and potential for future contribution to the Company, the number of options and awards previously granted to the recipient and, for senior management (including the named executive officers), their progress toward achieving the Company s guidelines for stock ownership by senior management (executive officers are expected to own Company stock having a value of at least 75% of their base salary).

To maintain consistency with current trends in stock-based compensation, in Fiscal 2005, the Company amended its Stock Benefit Plan to eliminate the evergreen provision and set a fixed number of shares (3,532,226 shares) to be available for award under the Plan. The Company also transitioned from its traditional annual stock option/restricted stock grants to long-term performance restricted stock opportunities for its key employees over a two-year performance period. The Performance Restricted Stock is subject to an extended vesting period to encourage retention and long-term focus of key employees, as well as a stock price feature designed to reward key employees after shareholders have been rewarded. To implement this approach, the Committee has established net income and working capital performance targets, and, in the alternative, an increase in stockholder value target for a two fiscal year performance period commencing June 1, 2004. A key employee s opportunity to receive a performance restricted stock award and the number of shares to be awarded, is based on the Company achieving (i) the applicable performance targets during each of Fiscal 2005 and Fiscal 2006, and during an aggregate Fiscal 2005 and Fiscal 2006 performance period, or, in the alternative, (ii) the increase in shareholder value target. For Fiscal 2005, the Company achieved the pre-determined performance targets and the named executive officers received the performance restricted stock awards reflected in the Summary Compensation table below. The number of shares awarded to an individual reflects the Committee s assessment of the individual s level of responsibility in the Company and ability to contribute toward achievement of applicable targets.

Executive Perquisites

In addition to the Company s Welfare Plans and contractual benefits for executives discussed elsewhere, it has been the Company s historical practice to provide certain other executive perquisites to senior executives. The Company continues this practice and offers one or more of the following executive perquisites to named executive officers, depending on the individual executive s position, level of responsibility and total compensation package:

- Annual vehicle allowance
- Reimbursement of pre-approved professional, club and association fees and charges.
- Reimbursement of travel and related expenses in connection with participation in meetings of pre-approved not-for-profit educational and professional organizations
- Third party professional executive financial planning assistance

- Reimbursement of professional tax preparation fees
- Executive annual physical and preventative health program

The value/cost of such perquisites are included in the Summary Compensation Table below in accordance with SEC rules.

Chief Executive Officer Compensation

In Fiscal 2002, Mr. Storch s annual base salary was temporarily reduced effective October 1, 2001, as part of a Company-wide cost reduction effort following the events of September 11th. His salary level was partially reinstated to $661,466 in Fiscal 2003, and fully reinstated to $696,280 on June 1, 2004 (FY 2005). Effective June 1, 2005 (FY 2006), Mr. Storch received a 3% base salary increase to $717,168 annually. Pursuant to his Employment Agreement, for Fiscal 2005, Mr. Storch earned an annual incentive cash bonus equal to 119% of his base salary in effect on May 31, 2005, or $826,367, based on the Company s performance during the period, which exceeded pre-established sales revenue, cash flow from operations, earnings per share and long-term debt to capital ratio goals, all in a very difficult aviation and aerospace industry business environment. However, in view of Mr. Storch s desire to drive the Company toward a lower cost operating environment and to allocate more of the Company s Fiscal 2005 available bonus pool to other participants, Mr. Storch requested that his annual incentive bonus for Fiscal 2005 be reduced to 85% of his base salary or $591,838. The Compensation Committee honored that request.

In 2001, consistent with its philosophy that Mr. Storch, as the President and Chief Executive Officer, should have the opportunity, based on performance, to earn shares of Company stock and that the performance measures that govern his opportunities should be both economic and stockholder value related, the Board approved a long-term stock-based incentive program for Mr. Storch under the Stock Benefit Plan as part of his employment agreement. The program, which was approved by the stockholders, commenced on June 1, 2001 and ended on May 31, 2005 (the Compensation Committee is in the process of developing a replacement long-term performance incentive compensation plan for Mr. Storch to be effective commencing June 1, 2005). Under the program, Mr. Storch has the opportunity to receive annually under the Stock Benefit Plan, at the discretion of the Compensation Committee, (i) options in an amount determined by a fraction, the numerator of which is equal to up to 1.25 times his then current base salary and the denominator of which is equal to the fair market value of the common stock on the date of grant divided by three, and (ii) performance restricted stock in amounts (a) up to .9375 times his then current base salary based on the Company s average return on capital during the performance period as compared to the S&P 500 Composite average return on capital and (b) up to .9375 times his then current base salary based on the Company s common stock share price performance during the period as compared to the common stock share price performance of the Company s peer group as described in the Company s Proxy Statement from time to time. In July 2004, Mr. Storch waived his right to receive stock options and restricted stock for Fiscal 2005 pursuant to this long-term incentive plan, and in lieu thereof, became eligible to receive performance restricted stock under a two-year performance restricted stock program available to key employees, generally. Mr. Storch s performance restricted stock opportunity under such two-year performance restricted stock program is less than that provided for under the long-term incentive plan provided for in his employment agreement.

The tables which follow this report and accompanying footnotes and narrative reflect the decisions covered by the above discussion.

Federal Income Tax Considerations

IRC Section 162(m) generally prevents any public company from claiming a deduction for compensation in excess of $1 million for the Chief Executive Officer or any of the four highest compensated executive officers. This deduction limitation, however, does not apply to performance-based compensation that satisfies certain requirements under Section 162(m). The Compensation Committee has determined that it is in the best interests of the Company and its stockholders to structure compensation of executive officers so that compensation will not be subject to the deduction limit to the extent that it can reasonably do so in a manner that provides adequate incentives and allows the Company to attract and retain qualified executives. However, the Compensation Committee has previously and may in the future structure compensation arrangements that under certain circumstances may be subject to the deduction limit. None of the compensation paid by the Company in Fiscal 2005 was subject to the deduction limit.

Compensation Committee

James G. Brocksmith, Jr., Chairman
Ronald R. Fogleman
Ronald B. Woodard

SUMMARY COMPENSATION TABLE

The following table summarizes the total compensation earned by or paid for Fiscal Years 2003 through 2005 to the President and Chief Executive Officer and the four other most highly paid executive officers in Fiscal 2005.

Summary Compensation Table

		Annual Compensation			Long-Term Compensation		
Name and Principal Position	Fiscal Year	Salary ($)	Bonus ($)	Other Annual Compensation ($)1	Restricted Stock Award(s) ($)2	Securities Underlying Options (#)	All Other Compensation ($)3
DAVID P. STORCH	2005	695,477	591,838	69,500	695,061	753,566 4	76,600
PRESIDENT AND CHIEF	2004	661,466	496,100	67,800	348,000	481,261 5	84,300
EXECUTIVE OFFICER	2003	661,466	0				