AVIALL INC
Form 8-K
June 13, 2003

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): June 13, 2003

Aviall, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**1-12380**	**65-0433083**
(State or other jurisdiction of incorporation)	**(Commission File Number)**	**(I.R.S. Employer Identification No.)**

2750 Regent Boulevard

DFW Airport, Texas	**75261**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (972) 586-1000

Not Applicable

(Former name or former address, if changed since last report)

Item 9. Regulation FD Disclosure.

On June 13, 2003, Aviall, Inc. (the Company) announced that it intends to make, subject to market and other conditions, an offering of senior notes (Senior Notes). The Company expects the net proceeds from the offering to be approximately $192.5 million. If the offering is consummated, the Company will use approximately $84.3 million of the net proceeds to redeem the entire principal amount of Aviall Services outstanding 14% Senior Notes due 2007 (the 14% Notes) and approximately $108.2 million to reduce outstanding indebtedness under Aviall Services senior secured revolving credit facility (the Credit Facility). Concurrently with, and as a condition to, the sale of the Senior Notes, the Company will enter into an amendment to the Credit Facility to permit it to issue the Senior Notes, to redeem the 14% Notes, to pay dividends from the Company s direct and indirect subsidiaries to the Company to service the interest and principal on the Senior Notes and to modify certain covenants to reflect, among other items, the issuance of the Senior Notes.

The offering of the Senior Notes, the redemption of the 14% Notes, the reduction of the outstanding balance under the Credit Facility and the amendment to the Credit Facility are referred to herein collectively as the Refinancing . The Company believes that the consummation of the Refinancing will strengthen the Company s capital structure and enhance its ability to pursue its business strategy.

In connection with the Company s private placement of the Senior Notes, the Company provided the following information to potential investors.

Except as otherwise required by the context, references to the Company, we, us, or our refer to the combined business of the Company and all its subsidiaries; references to Aviall refer to Aviall, Inc.; and references to Aviall Services and ILS refer to Aviall Services, Inc. and Inventory Locator Service, LLC, respectively, each of which is a direct or indirect wholly-owned subsidiary of Aviall.

Summary Consolidated Financial Data

You should read the following data in conjunction with our audited and unaudited consolidated financial statements and the accompanying notes and the section entitled Management s Discussion and Analysis of Financial Condition and Results of Operations in our periodic reports filed with the Securities Exchange Commission. The summary data as of and for each of the three years in the period ended December 31, 2002 is derived from our audited consolidated financial statements. The summary data as of and for each of the three month periods ended March 31, 2002 and 2003, and for the twelve month period ended March 31, 2003, is derived from our audited and unaudited consolidated financial statements for such periods which, in the opinion of management, include all adjustments, consisting solely of normal recurring adjustments, necessary to present fairly the financial results for such periods. The results of operations for the twelve months ended March 31, 2003 is presented to reflect our most recent twelve months of actual results under our Rolls-Royce Model T56, or RR T56, contract. The results of operations for the three months and twelve months ended March 31, 2003 may not be indicative of the results to be expected for the year ended December 31, 2003.

	Year Ended December 31,			Three Months Ended March 31,		Twelve Months Ended March 31, 2003
	2000	2001	2002	2002	2003	
	(dollars in thousands)					
Selected Operating Data:						
Net sales(1)	$ 485,920	$ 506,160	$ 803,293	$ 167,603	$ 251,490	$ 887,180
Cost of sales(2)	377,379	398,821	646,477	130,511	209,150	725,116
Gross profit	108,541	107,339	156,816	37,092	42,340	162,064
Selling and administrative expenses(3)	82,042	87,729	95,412	24,082	25,243	96,573
Unusual (gain) loss(4)		2,810	(1,024)			(1,024)
Operating income	26,499	16,800	62,428	13,010	17,097	66,515
Loss on extinguishment of debt(5)		1,608				
Interest expense	8,407	10,291	22,578	5,590	5,863	22,851
Earnings from continuing operations before taxes	18,092	4,901	39,850	7,420	11,234	43,664
Provision for income taxes(6)(7)	7,526	2,464	13,199	2,894	4,064	14,369
Earnings from continuing operations	10,566	2,437	26,651	4,526	7,170	29,295
Earnings from discontinued operations(8)	1,062	322	3,026			3,026
Net earnings	$ 11,628	$ 2,759	$ 29,677	$ 4,526	$ 7,170	$ 32,321
Balance Sheet (at end of period):						
Cash and cash equivalents	$ 4,865	$ 2,526	$ 4,997	$ 4,764	$ 4,302	
Working capital(9)	136,354	258,429	316,682	273,505	329,726	
Inventory	134,156	241,635	348,027	250,836	327,069	
Total assets	395,451	533,229	652,464	577,474	631,238	
Total debt	90,422	200,854	221,407	198,802	219,854	
Convertible redeemable preferred stock		40,161	44,370	41,174	45,478	
Shareholders equity	191,674	194,842	228,602	209,468	234,821	
Other Financial Data:						
Net cash provided by (used for):						
Operating activities	$ (7,612)	$ (81,103)	$ (37,084)	$ (4,057)	$ 30,418	$ (2,609)
Investment activities	(16,581)	(37,008)	(17,137)	(2,604)	(1,365)	(15,898)
Financing activities	27,673	115,772	56,692	8,899	(29,748)	18,045
EBITDA(10)	35,052	27,455	75,325	16,462	20,546	79,409
Capital expenditures(11)	10,961	21,178	6,867	992	1,365	7,240
Purchase of distribution rights	5,645	24,889	10,398	1,732		8,666
Ratio of earnings to fixed charges(12)	2.6x	1.3x	2.2x	1.9x	2.3x	2.3x

Pro Forma Data(13):

Interest expense	$	22,309
Total debt (at end of period)		239,777
Ratio of EBITDA to interest expense		3.6x
Ratio of total debt to EBITDA		3.0x

(1) Net sales for 2002, the three months ended March 31, 2002 and the twelve months ended March 31, 2003 do not include approximately $74 million, $40 million and $34 million, respectively, of RR T56 sales, valued at our contractual prices, made directly by Rolls-Royce Corporation to the U.S. military during the RR T56 transition period, which ended in June 2002.

(2) In 2001, cost of sales included a $7.0 million inventory and intangible write-down resulting from the downturn in the aerospace industry. This write-down was reclassified to cost of sales from selling and administrative expenses to conform to the 2002 presentation.

(3) In 2001, we expensed $1.4 million, which was included in selling and administrative expenses, related to the relocation of our Dallas-Fort Worth Airport facility.

(4) The unusual gain in 2002 and the twelve months ended March 31, 2003 resulted from the reversal of environmental reserves related to previously owned businesses that do not qualify as discontinued operations. The unusual loss in 2001 consists of write-downs of unfavorable leases and doubtful accounts related to the downturn in the economy in 2001 and costs related to our new capital structure.

(5) The loss on extinguishment of debt in 2001 resulted from the write-off of unamortized financing costs in connection with refinancing our former credit facility. This loss was reclassified from an extraordinary item to earnings from continuing operations before taxes to conform to FAS 145.

(6) In 2002 and the twelve months ended March 31, 2003, our tax expense was net of a $0.8 million release of state net operating loss valuation allowances determined to be realizable.

(7) Our cash payments for taxes are substantially lower than reported tax expense due to our use of net operating loss carryforwards, which are not expected to be fully utilized for several years.

(8) In January 1996, we exited certain businesses and reported these businesses as discontinued operations. The earnings from discontinued operations resulted from changes in estimates for certain retained liabilities.

(9) Working capital is calculated as current assets less cash minus current liabilities less current portion of long term debt and credit facility.

(10) EBITDA represents earnings from continuing operations before depreciation, amortization, interest and related expense and tax expense. In 2001, interest and related expense includes the write-off of unamortized financing costs in connection with refinancing our former credit facility. In no event should EBITDA be considered as an alternative to net earnings or any other GAAP measure as an indicator of our performance, nor should EBITDA be considered as an alternative to cash flows provided by operating activities as an indicator of cash flows or a measure of liquidity. We believe that EBITDA is a useful measure, along with other measurements under GAAP, in evaluating our financial performance and our ability to service our debt and is a conventionally used financial indicator. In addition, management uses EBITDA as a financial measure to evaluate our operating performance. The following table reconciles earnings from continuing operations to EBITDA for the periods presented.

	Year Ended December 31,			Three Months Ended March 31,		Twelve Months Ended March 31,
	2000	2001	2002	2002	2003	2003
	(dollars in thousands)					
Earnings from continuing operations	$ 10,566	$ 2,437	$ 26,651	$ 4,526	$ 7,170	$ 29,295
Plus:						
Income tax expense	7,526	2,464	13,199	2,894	4,064	14,369
Interest and related expense	8,407	11,899	22,578	5,590	5,863	22,851
Depreciation and amortization expense	8,553	10,655	12,897	3,452	3,449	12,894
EBITDA	$ 35,052	$ 27,455	$ 75,325	$ 16,462	$ 20,546	$ 79,409

(11) Capital expenditures in 2001 includes non-cash capital leases of $9.0 million

(12) For the purposes of calculating the ratio of earnings to fixed charges, earnings represents earnings from continuing operations before taxes and fixed charges. Fixed charges include interest expense, amortization of deferred debt issuance cost, the portion of operating rental expense that management believes is representative of the appropriate interest component of rent expense and the amount of pre-tax earnings required to pay preferred stock dividends.

(13) The data presented on a pro forma basis gives effect to the Refinancing as if it had occurred prior to March 31, 2002 for the income statement items and on March 31, 2003 for the balance sheet items. The calculations assume an 8.25% interest rate on the $200.0 million aggregate principal amount of Senior Notes, the redemption of the 14% Notes in full and a $108.2 million reduction in the outstanding indebtedness under the Credit Facility. Pro forma interest expense for the twelve months ended March 31, 2003 is computed by reducing the historical interest expense of $22.9 million for the period by the historical interest expense of $20.2 million on the 14% Notes and the portion of the outstanding balance of the Credit Facility expected to be repaid with the net proceeds of the Senior Notes offering and by increasing the pro forma interest expense by the interest expense on the Senior Notes, estimated to be $19.6 million.

RISK FACTORS

Risks Relating to Our Business

Our dependence on the aerospace industry makes us susceptible to negative trends and adverse economic conditions in the aerospace industry.

Virtually all of Aviall Services net sales and operating income are derived from the sale of parts, components, supplies and services to customers in the aerospace industry. As a result, Aviall Services business is directly affected by trends and economic factors that affect flight activity in the aerospace industry, including fuel prices, economic cycles, inflation, labor instability and regulatory oversight, as well as other factors that affect flying activity by the U.S. military and its allies.

Reduced flight activity generally results in reduced demand for parts, components, supplies and services by customers in the aerospace industry. Because a high proportion of Aviall Services operating costs are relatively fixed, reduced sales have a negative impact on its earnings, as lower gross profits cannot be offset by lower expenses. Further, because we purchase parts, components and supplies from our suppliers in advance of orders from our customers based upon our estimates of future demand, the effect of reduced demand can have an even greater impact on our earnings. If expected sales do not materialize, our inventory levels could increase, resulting in increased financing requirements and interest expense and reducing the credit available under the Credit Facility.

The demand for commercial air transport has been reduced by the prevailing global economic slowdown, terrorist attacks and their aftermath, military activity in Iraq and the uncertainty caused by Severe Acute Respiratory Syndrome, or SARS. This reduced flight activity, which has accelerated retirement of older aircraft and caused the deferral of nonessential aircraft maintenance and overhaul services, has reduced the demand for our parts, components and supplies used on commercial aircraft. In addition, some air operations have been reduced because commercial airlines, air freight carriers and other commercial airline-related firms around the world are experiencing large financial losses, which in some cases have resulted in bankruptcies. We cannot predict the length of time required for a recovery of the global commercial aviation sector, and any recovery could be hindered by a number of factors, including slower economic growth, foreign political instability or acts of war or terrorism.

In recent periods, we have relied heavily on increased flight activity by the U.S. military and foreign militaries, particularly with respect to aircraft fitted with the RR T56 series engine, to offset the decrease in commercial aviation activity. The U.S. military and certain foreign militaries may not sustain their current levels of flight activity and the demand for parts and components for military aircraft utilizing the RR T56 engine in particular may not continue to increase. As a result, we may be unable to realize fully all of the benefits that we hope to receive from our RR T56 engine parts agreement with Rolls-Royce Corporation, or Rolls-Royce. Moreover, if some or all of these militaries were to effect an extensive, protracted grounding of their fleets of Hercules C-130 aircraft, the primary aircraft on which RR T56 engines are fitted, our business would be severely disrupted. Under the terms of our agreement with Rolls-Royce, we are required to purchase approximately $367.4 million of RR T56 engine parts from Rolls-Royce in 2003. As of March 31, 2003, we have purchased $75.7 million RR T56 parts. If demand for RR T56 engine parts decreases substantially, our inventory levels of RR T56 engine parts could grow too large, increasing our financing requirements and interest expense and reducing the credit available under the credit facility.

In addition, the demand for our parts, components and supplies could decrease if one or more of our customers were to eliminate or retire one or more of their aircraft fleet types. Further, the demand for our parts, components and supplies could decrease if intense competition in the aerospace industry or other factors cause one or more of our customers to go out of business. Any decreases in demand for our parts, components and supplies could have a material adverse effect on our business, financial condition, results of operation or the trading price of the Senior Notes.

5

If our principal suppliers terminate or limit their relationships with us, our net sales could decline substantially and our business could otherwise be adversely affected.

Since November 1, 1999, we have entered into several significant, long-term agreements with Rolls-Royce and Honeywell Corporation, or Honeywell, to sell their parts. During 2002, sales of parts from Rolls-Royce accounted for approximately 51.4%, and sales of parts from Honeywell accounted for approximately 4.4%, of Aviall Services net sales, respectively. We expect these agreements to continue to represent a substantial percentage of our future net sales.

While our agreements with Honeywell and Rolls-Royce are ten-year agreements, each of these agreements contains a termination for convenience provision that allows the other party to terminate the agreement on the dates and subject to the advance notice provisions set forth below:

Supplier	Parts	Earliest Date for Notice of Termination for Convenience	Notice Requirement
Rolls-Royce	Rolls-Royce Model T56 engine parts	January 1, 2007	120 days
Rolls-Royce	Rolls-Royce Model 250 engine parts	January 1, 2003	120 days
Honeywell	Hydromechanical controls for Rolls-Royce Model 250 and Honeywell LT101 series engines	January 1, 2002	60 days
Honeywell	Honeywell engine systems accessories and environmental control systems	April 1, 2006	60 days
Honeywell	Hydromechanical controls for Rolls-Royce Model T56 engines	June 30, 2004	60 days
Honeywell	Hydromechanical controls for Pratt and Whitney PT6, PW 100 and JT15D turbine engines	June 27, 2002	30 days

Honeywell and Rolls-Royce may also terminate these agreements if we materially breach or fail to make payments under these agreements, or if we become bankrupt or insolvent or commence bankruptcy proceedings. Furthermore, Rolls-Royce may terminate our agreements to provide RR T56 engine parts and Rolls-Royce Model 250, or RR 250, engine parts upon 120-days prior written notice upon a change of control of Rolls-Royce, if we are acquired by a competitor of Rolls-Royce, or if we are acquired by a person that is not a competitor of Rolls-Royce and the acquisition causes our credit rating to fall one notch below our credit rating prior to the acquisition.

In the event that Rolls-Royce or Honeywell discontinue production of the products we sell or terminate or fail to perform under our agreements with them, and we are otherwise unable to obtain the parts we need to fulfill our customers orders, our results of operations and the trading price of the Senior Notes would likely be materially adversely affected.

Our largest customers represent a large percentage of our total business and loss of all or some of these customers could have a material adverse effect on our results of operations.