

AVIALL INC  
Form 10-Q  
May 02, 2005

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

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**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2005

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-12380

**AVIALL, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**65-0433083**  
(I.R.S. Employer  
Identification No.)

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**2750 Regent Boulevard**  
**DFW Airport, Texas**  
(Address of principal executive offices)

**75261-9048**  
(Zip Code)

**(972) 586-1000**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The number of shares of common stock, par value \$0.01 per share, outstanding at April 25, 2005 was 33,461,987.

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## AVIALL, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands, except share and per share data)

(Unaudited)

	<i>Three Months Ended March 31,</i>	
	<u>2005</u>	<u>2004</u>
Net sales	\$ 291,448	283,532
Cost of sales	238,281	236,434
Gross profit	53,167	47,098
Selling and administrative expense	28,086	27,599
Operating income	25,081	19,499
Interest expense, net	5,103	4,345
Earnings before income taxes	19,978	15,154
Provision for income taxes	6,978	5,177
Net earnings	\$ 13,000	9,977
Basic net earnings per share	\$ 0.40	0.31
Weighted average common shares	32,847,388	31,744,620
Diluted net earnings per share	\$ 0.38	0.30
Weighted average common and potentially dilutive common shares	34,605,983	33,242,755

*See accompanying notes to consolidated financial statements.*

## AVIALL, INC.

## CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except share and per share data)

(Unaudited)

	<i>March 31,</i> <i>2005</i>	<i>December 31,</i> <i>2004</i>
	<u>          </u>	<u>          </u>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 10,741	91,632
Receivables, net	154,979	144,087
Inventories	308,021	328,129
Prepaid expenses and other current assets	5,330	2,953
Deferred income taxes	33,798	40,432
	<u>          </u>	<u>          </u>
Total current assets	512,869	607,233
	<u>          </u>	<u>          </u>
Property and equipment	34,179	33,929
Goodwill	46,843	46,843
Intangible assets	200,886	46,525
Deferred income taxes	3,226	3,229
Other assets	12,843	11,717
	<u>          </u>	<u>          </u>
Total assets	\$ 810,846	749,476
	<u>          </u>	<u>          </u>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Current portion of long-term debt	\$ 1,190	1,440
Revolving line of credit	82,218	
Cash overdrafts due to outstanding checks	23,602	43,023
Accounts payable	86,534	98,629
Accrued expenses	40,454	46,741
	<u>          </u>	<u>          </u>
Total current liabilities	233,998	189,833
	<u>          </u>	<u>          </u>
Long-term debt	200,449	201,990
Other liabilities	7,435	8,652
Commitments and contingencies		
Shareholders' equity:		
Common stock (\$0.01 par value per share, 80,000,000 shares authorized; 35,507,978 shares and 34,582,746 shares issued at March 31, 2005 and December 31, 2004, respectively)	355	346
Additional paid-in capital	454,152	447,060
Accumulated deficit	(49,130)	(62,130)
Treasury stock, at cost (2,050,411 shares and 2,035,124 shares at March 31, 2005 and December 31, 2004, respectively)	(28,589)	(28,218)
Unearned compensation - restricted stock	(1,446)	(1,679)
Accumulated other comprehensive loss	(6,378)	(6,378)
	<u>          </u>	<u>          </u>
Total shareholders' equity	368,964	349,001
	<u>          </u>	<u>          </u>
Total liabilities and shareholders' equity	\$ 810,846	749,476



*See accompanying notes to consolidated financial statements.*

## AVIALL, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	<i>Three Months Ended March 31,</i>	
	<u>2005</u>	<u>2004</u>
<b><i>Operating activities:</i></b>		
Net earnings	\$ 13,000	9,977
Depreciation and amortization	5,372	4,293
Deferred income taxes	6,634	4,328
Compensation expense on restricted stock awards	233	183
Changes in:		
Receivables, net	(10,892)	(10,328)
Inventories	20,108	6,418
Accounts payable	(12,095)	12,258
Accrued expenses	(6,287)	2,893
Other, net	(4,468)	(1,625)
	<u>11,605</u>	<u>28,397</u>
Net cash provided by operating activities	11,605	28,397
<b><i>Investing activities:</i></b>		
Purchase of distribution rights	(157,000)	(800)
Capital expenditures	(2,713)	(1,432)
Sales of property, plant and equipment	300	6
	<u>(159,413)</u>	<u>(2,226)</u>
Net cash used for investing activities	(159,413)	(2,226)
<b><i>Financing activities:</i></b>		
Net change in revolving credit facility	82,218	(36)
Cash overdrafts due to outstanding checks	(19,421)	(37,990)
Issuance of common stock	7,101	1,170
Debt issuance cost paid	(1,898)	(99)
Debt repaid	(712)	(860)
Purchase of treasury stock	(371)	(351)
	<u>66,917</u>	<u>(38,166)</u>
Net cash provided by (used for) financing activities	66,917	(38,166)
Change in cash and cash equivalents	(80,891)	(11,995)
Cash and cash equivalents, beginning of period	91,632	23,424
	<u>10,741</u>	<u>11,429</u>
Cash and cash equivalents, end of period	\$ 10,741	11,429
<b><i>Cash paid (received) for interest and income taxes:</i></b>		
Interest	\$ 7,902	431
Income taxes	\$ 597	(266)

See accompanying notes to consolidated financial statements.



## AVIALL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 1 - BASIS OF PRESENTATION

The accompanying unaudited financial statements have been prepared in accordance with generally accepted accounting principles, or GAAP, for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, these financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three-month period ended March 31, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005. For further information, refer to the consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2004.

## NOTE 2 - STOCK-BASED COMPENSATION

We account for our stock-based compensation plans in accordance with the recognition and measurement principles of Accounting Principles Board Opinion No. 25, or APB 25, Accounting for Stock Issued to Employees, and related interpretations. All options granted under our plans have an exercise price equal to the market value of the underlying common stock on the date of grant. Therefore, no compensation cost related to these plans is included in net earnings. We also make the appropriate disclosures as required by Statement of Financial Accounting Standards No. 123, or SFAS 123, Accounting for Stock-Based Compensation, and Statement of Financial Accounting Standards No. 148, or SFAS 148, Accounting for Stock-Based Compensation - Transition and Disclosure - an Amendment of FAS 123. Awards of restricted stock are valued at the market price of our common stock on the date of grant and recorded as unearned compensation within shareholders' equity. The unearned compensation is amortized to compensation expense over the vesting period of the restricted stock.

The following table illustrates the effect on net earnings and earnings per share, or EPS, if we had applied the fair-value recognition provisions of SFAS 123 to stock-based employee compensation:

<i>(In Thousands, Except Per Share Data)</i>	<i>Three Months Ended</i>	
	<i>March 31,</i>	
	<i>2005</i>	<i>2004</i>
Net earnings, as reported	\$ 13,000	9,977
Deduct: Total stock-based compensation expense determined under fair-value-based method for all awards, net of related tax effects	(663)	(451)
Pro forma net earnings for purposes of computing basic net EPS	\$ 12,337	9,526
Earnings per share:		
Basic - as reported	\$ 0.40	0.31
Basic - pro forma	\$ 0.38	0.30
Diluted - as reported	\$ 0.38	0.30
Diluted - proforma	\$ 0.36	0.29





**NOTE 3 - NEW ACCOUNTING PRONOUNCEMENTS**

In December 2004, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards No. 123 (revised 2004), or SFAS 123R, Share-Based Payment, which replaces Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, and supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FAS 123. SFAS 123R addresses the accounting for share-based payment transactions in which a company receives employee services in exchange for either equity instruments of the company or liabilities that are based on the fair value of the company's equity instruments or that may be settled by the issuance of such equity instruments. SFAS 123R addresses all forms of share-based payment awards, including shares issued under employee stock purchase plans, stock options, restricted stock and stock appreciation rights. SFAS 123R eliminates the ability to account for share-based compensation transactions using the intrinsic method and generally would require that such transactions be accounted for using a fair-value-based method and recognized as expense over the period during which an employee is required to provide services in exchange for the award. SFAS 123R is effective for annual periods beginning after June 15, 2005. As such, we will implement the provisions of SFAS 123R effective January 1, 2006. We are in the process of evaluating the three allowable methods of transition to SFAS 123R but have not yet determined which method will be used. In 2006, we will incur compensation expense under SFAS 123R, as currently written, related to unvested options granted prior to January 1, 2006.

**NOTE 4 - SEGMENT INFORMATION**

The following tables present information by operating segment (in thousands):

	<i>Three Months Ended</i> <i>March 31,</i>	
	<u>2005</u>	<u>2004</u>
<b><i>Net Sales</i></b>		
Aviall Services	\$ 284,023	276,421
ILS	7,425	7,111
	<u>          </u>	<u>          </u>
Total net sales	\$ 291,448	283,532
	<u>          </u>	<u>          </u>
<b><i>Profit</i></b>		
Aviall Services	\$ 26,417	20,266
ILS	2,811	2,548
	<u>          </u>	<u>          </u>
Reportable segment profit	29,228	22,814
Corporate	(4,147)	(3,315)
Interest expense, net	(5,103)	(4,345)
	<u>          </u>	<u>          </u>
Earnings before income taxes	\$ 19,978	15,154
	<u>          </u>	<u>          </u>

**NOTE 5 - EARNINGS PER SHARE**

A reconciliation of the denominator of the basic and diluted EPS calculations for net earnings follows:

	<i>Three Months Ended March 31,</i>	
	<i>2005</i>	<i>2004</i>
<b><i>Denominator</i></b>		
Weighted average common shares	32,847,388	31,744,620
Effect of dilutive securities:		
Stock options	1,257,315	931,338
Restricted stock rights	238,880	304,467
Warrants	262,400	262,330
<b>Weighted average common and dilutive potential common shares</b>	<b>34,605,983</b>	<b>33,242,755</b>

Basic EPS is computed by dividing net earnings by the weighted average number of common shares outstanding during the period. Diluted EPS is computed by dividing net earnings by the weighted average number of common and dilutive potential common shares outstanding during the period.

**NOTE 6 - INCOME TAXES**

Our effective tax rate increased from 27.6% at December 31, 2004 to 34.9% at March 31, 2005. The lower effective rate at December 31, 2004 is primarily due to the release in 2004 of a \$3.4 million valuation allowance for state tax net operating loss carryforwards.

**NOTE 7 - INTANGIBLE ASSETS**

In January 2005, we entered into a distribution agreement with GE Engine Services, LLC and General Electric, or GE, whereby GE has appointed us as the exclusive worldwide distributor of unique parts for the GE CF6-50 and CF6-80A, or CF6, engines for as long as these engines remain in service. As a result of the GE CF6 agreement, we recorded \$157.0 million for distribution rights.

**NOTE 8 - DEBT**

On January 28, 2005, we entered into an amendment to our senior secured credit facility, or the Credit Facility, to increase the facility size, restructure the borrowing base, extend the termination date and change certain financial ratios and covenants. As of March 31, 2005, our amended Credit Facility consists of a \$260.0 million revolving credit and letter of credit facility due as a balloon payment in 2008. As of March

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31, 2005, we had \$82.2 million of borrowings outstanding under the Credit Facility.

**NOTE 9 - PENSION PLANS AND POSTRETIREMENT BENEFITS**

The following table sets forth the components of net pension expense for all our plans:

<i>(In Thousands)</i>	<i>Three Months Ended</i>	
	<i>March 31,</i>	
	<i>2005</i>	<i>2004</i>
Service cost	\$ 736	615
Interest cost	1,028	969
Expected return on plan assets	(1,086)	(963)
Transition obligation amortization	34	35
Prior service cost amortization	1	1
Net loss recognition	297	117
<b>Net pension expense</b>	<b>\$ 1,010</b>	<b>774</b>

The following table sets forth the components of net postretirement benefit income for all our plans:

<i>(In Thousands)</i>	<i>Three Months Ended</i>	
	<i>March 31,</i>	
	<i>2005</i>	<i>2004</i>
Service cost	\$	
Interest cost	18	22
Net amortization and deferral	(35)	(34)
Net postretirement benefit income	\$ (17)	(12)

#### NOTE 10 - GUARANTOR AND NONGUARANTOR FINANCIAL STATEMENTS

Our senior unsecured notes, or the Senior Notes, are fully and unconditionally and jointly and severally guaranteed on a senior unsecured basis by each direct and indirect domestic subsidiary of Aviall, Inc., or Aviall, each a guarantor subsidiary. Each guarantor subsidiary is directly or indirectly 100% owned by Aviall. The Senior Notes are not guaranteed by any direct or indirect foreign subsidiary of Aviall, each a nonguarantor subsidiary.

The unaudited consolidating financial information presents the consolidating balance sheets as of March 31, 2005 and December 31, 2004 and the related statements of operations and cash flows for the three-month periods ended March 31, 2005 and 2004 with separate columns for:

- a) Aviall, the parent;
- b) the guarantor subsidiaries on a combined basis;
- c) the nonguarantor subsidiaries on a combined basis; and
- d) total consolidated amounts.

The information includes elimination entries necessary to consolidate Aviall, the parent, with the guarantor and nonguarantor subsidiaries.

Investments in subsidiaries are accounted for by the parent using the equity method of accounting. The guarantor and nonguarantor subsidiaries are presented on a combined basis. The principal elimination entries eliminate investments in subsidiaries and intercompany balances and transactions. Separate financial statements for the guarantor and nonguarantor subsidiaries are not presented because management believes such financial statements would not be meaningful to investors.

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Pursuant to the terms of the Credit Facility, no subsidiary of Aviall other than Aviall Services, Inc., or Aviall Services, may pay cash dividends to Aviall, other than to fund limited repurchases or redemptions of outstanding securities. In addition, Aviall Services may pay cash dividends to Aviall for the purpose of funding (i) ordinary operating expenses and scheduled debt service, (ii) payments by Aviall of taxes in respect of Aviall and its subsidiaries, up to the amount that would be payable by Aviall Services, on a consolidated basis, if it were the taxpayer and (iii) any repurchase of the Senior Notes permitted under the terms of the Credit Facility. Additionally, the Credit Facility restricts intercompany loans made to Aviall from its direct and indirect subsidiaries, with the exception of intercompany loans made to fund limited repurchases or redemptions of outstanding securities and loans made by Aviall Services to fund required payments under the Senior Notes. The net assets of consolidating subsidiaries subject to these restrictions were \$706.4 million and \$714.8 million at March 31, 2005 and December 31, 2004, respectively.

**CONSOLIDATED STATEMENT OF OPERATIONS**

<i>(In Thousands)</i>	<i>Three Months Ended March 31, 2005</i>				
	<i>Parent</i>	<i>Guarantor Subsidiaries</i>	<i>Nonguarantor Subsidiaries</i>	<i>Eliminations</i>	<i>Consolidated Total</i>
Net sales	\$	272,297	35,293	(16,142)	291,448
Cost of sales		225,654	28,769	(16,142)	238,281
Gross profit		46,643	6,524		53,167
Selling and administrative expense		23,846	4,240		28,086
Operating income		22,797	2,284		25,081
Interest expense (income)	(4,645)	9,682	66		5,103
Equity in (earnings) loss of subsidiaries	(10,037)	(1,981)		12,018	
Earnings (loss) before income taxes	14,682	15,096	2,218	(12,018)	19,978
Provision for income taxes	1,682	5,059	237		6,978
Net earnings (loss)	\$ 13,000	10,037	1,981	(12,018)	13,000

**CONSOLIDATED STATEMENT OF OPERATIONS**

<i>(In Thousands)</i>	<i>Three Months Ended March 31, 2004</i>				
	<i>Parent</i>	<i>Guarantor Subsidiaries</i>	<i>Nonguarantor Subsidiaries</i>	<i>Eliminations</i>	<i>Consolidated Total</i>
Net sales	\$	268,185	31,554	(16,207)	283,532
Cost of sales		227,260	25,381	(16,207)	236,434
Gross profit		40,925	6,173		47,098
Selling and administrative expense		24,292	3,307		27,599
Operating income		16,633	2,866		19,499
Interest expense (income)	(4,243)	8,497	91		4,345
Equity in (earnings) loss of subsidiaries	(7,270)	(2,037)		9,307	
Earnings (loss) before income taxes	11,513	10,173	2,775	(9,307)	15,154
Provision for income taxes	1,536	2,903	738		5,177
Net earnings (loss)	\$ 9,977	7,270	2,037	(9,307)	9,977

## CONSOLIDATED BALANCE SHEET

	<i>March 31, 2005</i>				
<i>(In Thousands)</i>	<i>Parent</i>	<i>Guarantor Subsidiaries</i>	<i>Nonguarantor Subsidiaries</i>	<i>Eliminations</i>	<i>Consolidated Total</i>
<b>Assets</b>					
Current assets:					
Cash and cash equivalents	\$ (30)	8,040	2,731		10,741
Receivables, net		128,768	26,211		154,979
Inventories		294,838	13,183		308,021
Prepaid expenses and other current assets		5,159	171		5,330
Deferred income taxes		33,776	22		33,798
<b>Total current assets</b>	<b>(30)</b>	<b>470,581</b>	<b>42,318</b>		<b>512,869</b>
Property and equipment		33,624	555		34,179
Investment in subsidiaries	752,142	36,265		(788,407)	
Intercompany receivables		204,046		(204,046)	
Goodwill		44,904	1,939		46,843
Intangible assets		200,886			200,886
Deferred income taxes		2,816	410		3,226
Other assets	6,248	6,592	3		12,843
<b>Total assets</b>	<b>\$ 758,360</b>	<b>999,714</b>	<b>45,225</b>	<b>(992,453)</b>	<b>810,846</b>
<b>Liabilities and Shareholders' Equity</b>					
Current liabilities:					
Current portion of long-term debt	\$	1,179	11		1,190
Revolving line of credit		82,218			82,218
Cash overdrafts due to outstanding checks	5	23,597			23,602
Accounts payable		85,394	1,140		86,534
Accrued expenses	3,845	33,436	3,173		40,454
<b>Total current liabilities</b>	<b>3,850</b>	<b>225,824</b>	<b>4,324</b>		<b>233,998</b>
Long-term debt	200,000	442	7		200,449
Intercompany payables	185,546		18,500	(204,046)	
Other liabilities		7,435			7,435
Commitments and contingencies					
Shareholders' equity					
Common stock	355	33	7,542	(7,575)	355
Additional paid-in capital	454,152	867,920	9,919	(877,839)	454,152
Retained earnings (accumulated deficit)	(49,130)	(95,562)	4,933	90,629	(49,130)
Treasury stock, at cost	(28,589)				(28,589)
Unearned compensation - restricted stock	(1,446)				(1,446)
Accumulated other comprehensive income	(6,378)	(6,378)		6,378	(6,378)
<b>Total shareholders' equity</b>	<b>368,964</b>	<b>766,013</b>	<b>22,394</b>	<b>(788,407)</b>	<b>368,964</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 758,360</b>	<b>999,714</b>	<b>45,225</b>	<b>(992,453)</b>	<b>810,846</b>





**CONSOLIDATED BALANCE SHEET**

	<i>December 31, 2004</i>				
<i>(In Thousands)</i>	<i>Parent</i>	<i>Guarantor Subsidiaries</i>	<i>Nonguarantor Subsidiaries</i>	<i>Eliminations</i>	<i>Consolidated Total</i>
<b>Assets</b>					
Current assets:					
Cash and cash equivalents	\$ (35)	83,002	8,665		91,632
Receivables, net		116,938	27,149		144,087
Inventories		315,298	12,831		328,129
Prepaid expenses and other current assets		2,824	129		2,953
Deferred income taxes		40,410	22		40,432
<b>Total current assets</b>	<b>(35)</b>	<b>558,472</b>	<b>48,796</b>		<b>607,233</b>
Property and equipment		33,318	611		33,929
Investment in subsidiaries	764,005	34,284		(798,289)	
Intercompany receivables		235,007		(235,007)	
Goodwill		44,904	1,939		46,843
Intangible assets		46,525			46,525
Deferred income taxes		2,816	413		3,229
Other assets	6,498	5,214	5		11,717
<b>Total assets</b>	<b>\$ 770,468</b>	<b>960,540</b>	<b>51,764</b>	<b>(1,033,296)</b>	<b>749,476</b>
<b>Liabilities and Shareholders' Equity</b>					
Current liabilities:					
Current portion of long-term debt	\$	1,429	11		1,440
Revolving line of credit					
Cash overdrafts due to outstanding checks	4	42,969	50		43,023
Accounts payable		97,368	1,261		98,629
Accrued expenses	7,723	35,827	3,191		46,741
<b>Total current liabilities</b>	<b>7,727</b>	<b>177,593</b>	<b>4,513</b>		<b>189,833</b>
Long-term debt	200,000	1,981	9		201,990
Intercompany payables	213,740		21,267	(235,007)	
Other liabilities		8,652			8,652
Commitments and contingencies					
Shareholders' equity					
Common stock	346	33	7,542	(7,575)	346
Additional paid-in capital	447,060	862,357	9,918	(872,275)	447,060
Retained earnings (accumulated deficit)	(62,130)	(83,698)	8,515	75,183	(62,130)
Treasury stock, at cost	(28,218)				(28,218)
Unearned compensation - restricted stock	(1,679)				(1,679)
Accumulated other comprehensive (loss) income	(6,378)	(6,378)		6,378	(6,378)
<b>Total shareholders' equity</b>	<b>349,001</b>	<b>772,314</b>	<b>25,975</b>	<b>(798,289)</b>	<b>349,001</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 770,468</b>	<b>960,540</b>	<b>51,764</b>	<b>(1,033,296)</b>	<b>749,476</b>



**CONSOLIDATED STATEMENT OF CASH FLOWS**

<i>(In Thousands)</i>	<i>Three Months Ended March 31, 2005</i>				
	<i>Parent</i>	<i>Guarantor Subsidiaries</i>	<i>Nonguarantor Subsidiaries</i>	<i>Eliminations</i>	<i>Consolidated Total</i>
<b><i>Operating activities:</i></b>					
Net earnings (loss)	\$ 13,000	10,037	1,981	(12,018)	13,000
Depreciation and amortization	250	5,064	58		5,372
Deferred income taxes		6,634			6,634
Compensation expense on restricted stock awards	233				233
Changes in:					
Receivables, net		(11,830)	938		(10,892)
Inventories		20,460	(352)		20,108
Intercompany receivables and payables	(6,294)	14,625	(8,331)		
Accounts payable		(11,974)	(121)		(12,095)
Accrued expenses	(3,878)	(2,391)	(18)		(6,287)
Other, net		(4,432)	(36)		(4,468)
Net cash provided by (used for) operating activities	3,311	26,193	(5,881)	(12,018)	11,605
<b><i>Investing activities:</i></b>					
Capital expenditures		(2,712)	(1)		(2,713)
Purchase of distribution rights		(157,000)			(157,000)
Investment in subsidiaries	(10,037)	(1,981)		12,018	
Sales of property, plant and equipment		300			300
Net cash provided by (used for) investing activities	(10,037)	(161,393)	(1)	12,018	(159,413)
<b><i>Financing activities:</i></b>					
Debt issue costs paid		(1,898)			(1,898)
Issuance of common stock	7,101				7,101
Purchase of treasury stock	(371)				(371)
Net change in revolving credit facility		82,218			82,218
Cash overdrafts due to outstanding checks	1	(19,372)	(50)		(19,421)
Debt repaid		(710)	(2)		(712)
Net cash provided by (used for) financing activities	6,731	60,238	(52)		66,917
Change in cash and cash equivalents	5	(74,962)	(5,934)		(80,891)
Cash and cash equivalents, beginning of period	(35)	83,002	8,665		91,632
Cash and cash equivalents, end of period	\$ (30)	8,040	2,731		10,741

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**CONSOLIDATED STATEMENT OF CASH FLOWS**

	<i>Three Months Ended March 31, 2004</i>				
<i>(In Thousands)</i>	<i>Parent</i>	<i>Guarantor Subsidiaries</i>	<i>Nonguarantor Subsidiaries</i>	<i>Eliminations</i>	<i>Consolidated Total</i>
<b><i>Operating activities:</i></b>					
Net earnings (loss)	\$ 9,977	7,270	2,037	(9,307)	9,977
Depreciation and amortization	255	3,968	70		4,293
Deferred income taxes		4,337	(9)		4,328
Compensation expense on restricted stock awards	183				183
Changes in:					
Receivables		(6,366)	(3,962)		(10,328)
Inventories		7,262	(844)		6,418
Intercompany receivables and payables	(9,174)	3,782	5,392		
Accounts payable	(33)	12,122	169		12,258
Accrued expenses	3,812	(2,167)	1,248		2,893
Other, net	1,536	(3,130)	(31)		(1,625)
Net cash provided by (used for) operating activities	6,556	27,078	4,070	(9,307)	28,397
<b><i>Investing activities:</i></b>					
Capital expenditures		(1,432)			(1,432)
Purchase of distribution rights		(800)			(800)
Investment in subsidiaries	(7,270)	(2,037)		9,307	
Sales of property, plant and equipment		5	1		6
Net cash provided by (used for) investing activities	(7,270)	(4,264)	1	9,307	(2,226)
<b><i>Financing activities:</i></b>					
Debt issue costs paid	(99)				(99)
Issuance of common stock	1,170				1,170
Purchase of treasury stock	(351)				(351)
Net change in revolving credit facility			(36)		(36)
Cash overdrafts		(37,999)	9		(37,990)
Debt repaid		(857)	(3)		(860)
Net cash provided by (used for) financing activities	720	(38,856)	(30)		(38,166)
Change in cash and cash equivalents	6	(16,042)	4,041		(11,995)
Cash and cash equivalents, beginning of period		21,187	2,237		23,424
Cash and cash equivalents, end of period	\$ 6	5,145	6,278		11,429

**Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations**

*Executive Overview*

We are the largest independent global provider of new parts, supply-chain management and other related value-added services to the aerospace aftermarket. The aerospace aftermarket consists of parts needed for the scheduled and unscheduled maintenance, repair and modification of aircraft already in use but does not include parts used in the construction of new aircraft or engines. We serve this market through our two wholly owned subsidiaries, Aviall Services, Inc., or Aviall Services, and Inventory Locator Service, LLC, or ILS. Aviall Services provides new parts and related supply-chain management services to the aerospace industry, and ILS operates electronic marketplaces for buying and selling parts, equipment and services for the global aerospace, defense and marine industries.

Aviall Services purchases a broad range of new parts, components and supplies from over 220 original equipment manufacturers, or OEMs, including in some cases several business units within such manufacturers, and resells them to over 18,500 government/military, general aviation/corporate and commercial airline customers, including over 300 airlines. Aviall Services also provides value-added services to our customers and suppliers, such as repair and assembly services, supply-chain management services and information-gathering and delivery services.

ILS operates electronic marketplaces for buying and selling parts, equipment and services for the global aerospace, defense and marine industries. With more than 14,000 users in more than 85 countries, ILS's electronic marketplaces contain more than 55 million line items representing over five billion parts for sale. ILS also maintains databases of over 119 million cross-referenced United States, or U.S., government records, allowing users to research manufacturers and prices for specific parts, locate alternate parts, find additional uses and markets for parts and review U.S. government procurement histories.

Our first quarter 2005 net earnings of \$13.0 million or \$0.38 diluted earnings per share increased 30.0% compared to net earnings of \$10.0 million or \$0.30 diluted earnings per share in the first quarter of 2004. Our operating income in the first quarter of 2005 was \$25.1 million, an increase of \$5.6 million or 28.7% from the same quarter in 2004. These results were driven by the addition of commissions received for the sales of unique parts for General Electric, or GE, CF6-50 and CF6-80A, or CF6, engines which commenced in February 2005. During the GE transition, only commissions on parts directly shipped by GE will be recorded until we commence shipping, which is estimated to begin in the third quarter of 2005. In addition, our selling and administrative expense increased only \$0.5 million in the first quarter of 2005 compared to the first quarter of 2004 largely due to year-over-year higher salary and benefit expenses offset by lower bad debt expense. This continues our leveraging of selling and administrative expense as a percentage of sales. Accordingly, our first quarter 2005 selling and administrative expense as a percentage of sales was 9.6% compared to 9.7% in the first quarter of 2004.

Market conditions continue to be challenging during the first quarter of 2005. The combination of record high fuel costs, a slowing of growth in the economies of many regions and the uncertain future being faced by many of our airline customers and some general aviation aircraft operators have combined to make our future performance and opportunities less certain. However, we believe that these conditions also continue to support the need for the services offered by Aviall Services and ILS, which we believe is the principal reason for Aviall's improved results in 2004 and into 2005.

Our future strategy will continue to focus on the acquisition of new long-term supplier contracts as well as adding other traditional supplier relationships, delivering superior customer service and investing in technology and infrastructure to increase supplier and customer efficiencies. We will also continue to evaluate potential strategic acquisitions and changes to our capital structure. We believe our ability to grow at a pace similar to that which we have experienced since 2000 will depend on the award of one or a series of new long-term supplier contracts, the expansion of our traditional supplier base and product offerings and/or completion of a strategic acquisition. The timing and length of the process to procure new long-term agreements or relationships or a strategic acquisition is unpredictable. We are currently actively pursuing a number of opportunities for additional growth, including possible significant, new long-term supplier agreements. No assurance can be given

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that we will be able to procure any such new arrangements. To the extent we do secure any such relationship, the economies of scale derived from recent contracts may not be indicative of our future results, particularly in the early stages of new contract implementation. As an example of the implementation of this strategy, we signed two additional exclusive distribution services agreements with Hamilton Sundstrand in April 2005, bolstering our relationship which began in 2004. The multi-product agreements award us exclusive worldwide distribution rights for Hamilton Sundstrand-built spare parts that are unique to the 60kVA family of generators, the JT8D mechanical fuel controls, and the JT9D engine accessories. These parts are used on a wide range of aircraft, and we expect the agreements to generate approximately \$100 million of revenue over the next ten years.

We previously announced that net earnings from continuing operations in 2005 would be in the range of approximately \$55.0 million to \$57.5 million or equivalent to approximately \$1.60 to \$1.66 per diluted share based upon the then-existing number of diluted shares. Aviall remains comfortable with the previous earnings estimate given in February 2005.

### *Critical Accounting Policies*

For a discussion of our critical accounting policies, refer to Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies included in our Annual Report on Form 10-K for the year ended December 31, 2004. There have been no material changes to the critical accounting policies discussed in our Annual Report on Form 10-K for the year ended December 31, 2004.

### *Results of Operations-Three Months Ended March 31, 2005 Compared to Three Months Ended March 31, 2004*

**Net Sales.** Net sales for Aviall Services were \$284.0 million, an increase of \$7.6 million or 2.7% from the \$276.4 million recorded in the first quarter of 2004.

The following table presents sales for Aviall Services in each of its geographic regions and in all market sectors (amounts in millions):

	<i>Amount of Increase/ (Decrease)</i>	<i>Percentage Increase/ (Decrease)</i>
<b>Geographic region:</b>		
Europe	\$ 5.5	27.9%
Asia-Pacific	\$ 2.8	10.3%
Americas	\$ (0.7)	(0.3)%
<b>Market sector:</b>		
Commercial airline	\$ 8.6	13.2%
General Aviation/corporate	\$ 1.8	2.7%
Government/military	\$ (2.8)	(1.9)%

Sales in the commercial airline sector increased primarily due to stronger sales volumes in the sector as well as the addition of GE CF6 engine parts sales commissions, which commenced in February 2005. Sales in the general aviation/corporate sector increased modestly because of increased flight activity tempered by the effect of fuel prices. Sales in the government/military sector decreased slightly primarily due to lower deliveries of military-related parts under the Rolls-Royce T-56, or RR T56, distribution agreement. Sales of RR T56 products were \$119.3 million in the first quarter of 2005 and \$126.0 million in the first quarter of 2004. Aggregate sales of products supplied by Rolls-Royce and Honeywell were \$180.3 million and \$185.9 million in the first quarter of 2005 and 2004, respectively.

Net sales for ILS were \$7.4 million, an increase of \$0.3 million or 4.2% from the \$7.1 million recorded in the first quarter of 2004.



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**Gross Profit.** Gross profit of \$53.2 million increased \$6.1 million or 13.0% in the first quarter of 2005 compared to \$47.1 million in the first quarter of 2004. Gross profit as a percentage of net sales was 18.2% in the first quarter of 2005 as compared to 16.6% in the first quarter of 2004. The increased gross profit percentage was due to the addition of the GE CF6 engine parts sales commissions, which commenced in February 2005. During the GE transition, only commissions on parts directly shipped by GE will be recorded until we commence shipping, which is estimated to begin in the third quarter of 2005.

**Selling and Administrative Expense.** Selling and administrative expense increased \$0.5 million to \$28.1 million in the first quarter of 2005 but decreased as a percentage of net sales to 9.6% from 9.7% in the first quarter of 2004. Selling and administrative expense increased largely as a result of higher salary and benefit expenses offset by lower bad debt expense.

**Interest Expense.** Interest expense increased \$0.7 million to \$5.1 million in the first quarter of 2005 from \$4.4 million in the first quarter of 2004. Noncash interest expense amounted to \$0.4 million in both 2005 and 2004. Our net interest expense increased primarily due to the initial funding of the GE CF6 agreement and the continued borrowings outstanding under our senior secured credit facility, or the Credit Facility, which had a balance of \$82.2 million at March 31, 2005.

**Provision for Income Taxes.** Our income tax expense for the first quarter of 2005 was \$7.0 million, and our effective tax rate was 34.9%. Our income tax expense for the first quarter of 2004 was \$5.2 million, and our effective tax rate was 34.2%. The increase in our effective tax rate from 34.2% in 2004 to 34.9% in 2005 resulted primarily from a decrease in the allowable benefit for 2005 from the Extraterritorial Income exclusion.

Our effective tax rate increased from 27.6% at December 31, 2004 to 34.9% at March 31, 2005. The lower effective rate at December 31, 2004 is primarily due to the release in 2004 of a \$3.4 million valuation allowance for state tax net operating loss, or NOL, carryforwards.

Cash payments made for federal, state and foreign income taxes were \$0.6 million in the first quarter of 2005. Cash refunds received for federal, state and foreign income taxes were \$0.3 million in the first quarter of 2004. Our cash income tax expense is primarily comprised of Alternative Minimum Tax and foreign taxes on our foreign operations. Our cash income tax expense continues to be substantially lower than the U.S. federal statutory rate through the use of our U.S. federal NOL carryforward.

### *Liquidity and Capital Resources*

**Cash Flow.** Net cash flow provided by operations was \$11.6 million in the first three months of 2005 compared to \$28.4 million in the first three months of 2004. The \$16.8 million decrease in cash provided by operating activities in 2005 compared to the same period in 2004 primarily resulted from a low March 31, 2005 ending accounts payable balance due to the timing of month end settlements with our suppliers and a decrease in accrued expenses related to interest payment timing on the \$200 million of senior unsecured notes, or the Senior Notes, partially offset by increased cash earnings in 2005 and lower inventory levels at March 31, 2005. Aviall Services' inventory turns in March 2005 remained unchanged from December 2004 at 3.2 turns. The days' sales outstanding for Aviall's receivables decreased from 51 days at December 31, 2004 to 47 days at March 31, 2005 due to increased sales volume.

Capital expenditures were \$2.7 million in the first three months of 2005 compared to \$1.4 million in the first three months of 2004. Capital spending in both 2005 and 2004 was primarily for upgrades to Aviall Services' enterprise resource planning software, computer hardware and operations infrastructure. Based on the capital projects approved by our board of directors, we expect to make capital expenditures, including noncash capital amounts, totaling approximately \$11.0 million in 2005. These projects include upgrades and enhancements associated with both our systems and operations infrastructure at Aviall Services and ILS. We review our capital expenditure program periodically and modify it as required to meet current business needs. Under the Credit Facility, our capital expenditure limit is approximately \$17.2 million, comprised of a \$12.0 million limit for 2005 plus \$5.2 million of carryover amounts from prior years.

In January 2005, we entered into a distribution agreement with GE Engine Services, LLC and GE, whereby GE has appointed us as the exclusive worldwide distributor of unique parts for the CF6 engines for as long as these engines remain in service. As a result of the GE CF6 agreement, we recorded \$160.1 million for distribution rights and inventory.

Variable Working Capital (see definition below) increased \$2.9 million in the first three months of 2005 as compared to a decrease of \$8.3 million in the first three months of 2004. In 2005, we invested \$159.4 million in net capital expenditures and distribution rights as compared to \$2.2 million in 2004. The combined cash used in the first three months of 2005 of \$147.8 million by both operating and investing activities was funded by \$7.1 million received for common stock issued pursuant to the exercise of options, \$82.2 million of net borrowings under the Credit Facility and a majority of the \$91.6 million of cash on hand at the beginning of 2005. In addition, our cash overdraft position decreased \$19.4 million in the first quarter of 2005. As a result, our cash balance decreased by \$80.9 million.

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By way of comparison, the combined cash provided in the first three months of 2004 of \$26.2 million for both operating and investing activities together with the \$1.2 million received for common stock issued pursuant to the exercise of options and the use of \$12.0 million of the cash on hand at the beginning of 2004 funded the \$38.0 million decrease in our cash overdraft position last year. Overdraft positions arise when we settle our accounts payable by issuing checks at month-end, and the recipients of these checks have not presented them to our banks for payment before our cut-off for accounting purposes. We classify these overdraft positions as a separate current liability in our accompanying consolidated balance sheet because no right of offset existed against other cash accounts within the same bank. Generally accepted accounting principles, or GAAP, treat these amounts similar to debt in the statement of cash flows by presenting cash overdrafts as a financing activity. We expect to continue large month-end settlements with our major suppliers, but the overdrafts will change in accordance with the variable amounts of products shipped to us from time to time.

Assuming our current level of internal growth, profitability, and the present relationship between increased revenues, Variable Working Capital requirements and our annual capital expenditures, we expect to generate strong positive cash flows from operations although these may be offset from time to time by overdraft obligations and increases in Variable Working Capital, particularly when our business is growing. Assuming the foregoing, we project cash flow in 2005 for operating activities will exceed \$50.0 million. Our cash flow from operating activities also depends on the timing of the delivery and payment for inventory as discussed above. In some months, we receive much larger deliveries than the average of the preceding several months. These larger deliveries can significantly alter our cash flow for that month and on a cumulative basis for both the quarter and the fiscal year to date.

In 2005, we expect to fund our internal growth and any related capital expenditures out of cash flow from operations and borrowings under the Credit Facility. If we are awarded one or more additional long-term supplier agreements in 2005 that require significant investments in distribution rights and inventory, we may be required to increase availability and borrow significant amounts under the Credit Facility or we may be required to sell debt, equity or other securities under our shelf registration statement or otherwise to fund the costs associated with the investment. Likewise, if we enter into a strategic acquisition or if our current projections prove to be inaccurate in 2005, we may be required to borrow significant amounts under the Credit Facility or to sell securities.

The following table presents a reconciliation of our Variable Working Capital to working capital for the periods presented:

<i>(In Thousands)</i>	<i>Three Months Ended March 31,</i>	
	<i>2005</i>	<i>2004</i>
Receivables, net	\$ 154,979	149,607
Plus: Inventories	308,021	321,442
Less: Accounts payable	(86,534)	(107,080)
<b>Variable Working Capital</b>	<b>376,466</b>	<b>363,969</b>
Plus:		
Cash and cash equivalents	10,741	11,429
Prepaid expenses and other current assets	5,330	3,759
Deferred income taxes	33,798	19,075
Less:		
Current portion of long-term debt	(1,190)	(2,920)
Cash overdrafts due to outstanding checks	(23,602)	(5,625)
Revolving line of credit	(82,218)	(473)
Accrued expenses	(40,454)	(42,460)
<b>Working capital</b>	<b>\$ 278,871</b>	<b>346,754</b>

We define Variable Working Capital as receivables plus inventories less accounts payable. In no event should Variable Working Capital be considered as an alternative to working capital or any GAAP measure as an indicator of our performance, nor should Variable Working Capital be considered as an alternative to working capital as an indicator of our relative liquidity to meet our obligations within an ordinary business cycle. We believe that Variable Working Capital is a useful measure, along with measurements under GAAP, in evaluating our financial performance and our ability to leverage sales and earnings from our Variable Working Capital. In addition, we use Variable Working Capital as a financial measure to evaluate our management of working capital and as a metric to measure contract and supplier performance.

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**Senior Unsecured Debt.** We have \$200.0 million of Senior Notes outstanding. The Senior Notes bear interest at 7.625% per annum and mature on July 1, 2011, unless previously redeemed at our option. We may redeem some or all of the Senior Notes at specified redemption prices at any time after July 1, 2007. In addition, prior to July 1, 2006, we may redeem up to 35% of the Senior Notes from the proceeds of qualifying equity offerings.

The Senior Notes are our senior unsecured obligations and are equal in right of payment to all of our senior indebtedness. The Senior Notes are guaranteed on a senior unsecured basis by each of our domestic subsidiaries.

In November 2003, we entered into an interest rate swap agreement to manage interest rate risk exposure on \$50.0 million of the \$200.0 million principal amount of Senior Notes. Under this agreement which expires in 2011, we pay floating interest amounts in exchange for giving up the right to pay a fixed amount without an exchange of the underlying principal amount.

**Senior Secured Debt.** On January 28, 2005, we entered into an amendment to the Credit Facility in connection with the GE CF6 agreement. As amended, the Credit Facility consists of a \$260.0 million revolving credit and letter of credit facility due as a balloon payment in 2008, with availability determined by reference to a borrowing base calculated using our eligible accounts receivable and inventory and after deducting reserves required by the lenders. As of March 31, 2005, we had \$82.2 million of borrowings outstanding under the Credit Facility and had issued letters of credit for \$0.9 million. In addition, we had \$140.7 million available for additional borrowings under the Credit Facility and our borrowing base was \$223.8 million. As of March 31, 2005, borrowings under the Credit Facility bear interest based upon either: (1) a Eurodollar Rate plus an applicable margin ranging from 1.5% to 2.5% depending upon our financial ratios or (2) a Base Rate plus an applicable margin ranging from 0.5% to 1.5% depending upon the same financial ratios. We expect to utilize both of these interest rate options during 2005. As of March 31, 2005, the weighted average interest rate on the Credit Facility was 4.90%. An annual commitment fee of 0.5% is payable monthly in arrears on the daily unused portion of the Credit Facility. Obligations under the Credit Facility are collateralized by substantially all of our domestic assets and 65% of the stock of certain of our foreign subsidiaries. The Credit Facility also contains default clauses that permit the acceleration of all amounts due following an event of default at the discretion of the lenders, and lock-box provisions that apply our cash collections to outstanding borrowings. Based on the terms of the Credit Facility and pursuant to EITF Issue No. 95-22, Balance Sheet Classification of Revolving Credit Agreement Obligations Involving Lock-Box Arrangements, we classify amounts outstanding under the Credit Facility, if any, as current.

We also maintain a Canadian \$6.0 million secured revolving credit facility, or the Canadian Revolver. As of March 31, 2005, we had no borrowings outstanding under the Canadian Revolver.

**Debt Covenants.** The Credit Facility contains various restrictive operating and financial covenants, including several that are based on earnings before interest, taxes, depreciation, amortization, extraordinary gains or losses, and one-time items, or Adjusted EBITDA. We must comply with a maximum leverage ratio covenant that measures the ratio of our outstanding debt to our Adjusted EBITDA for the trailing four quarters. We must maintain a maximum leverage ratio of: 4.50 to 1 for the fiscal quarters ending on or before June 30, 2005; 4.00 to 1 for the fiscal quarter ending September 30, 2005; 3.50 to 1 for the fiscal quarter ending December 31, 2005; and 3.25 to 1 for the fiscal quarters ending on or after March 31, 2006. This maximum leverage ratio covenant was 4.50 to 1 at March 31, 2005. We must also comply with a minimum interest coverage ratio covenant that measures the ratio of our Adjusted EBITDA for the trailing four quarters to our interest expense during the trailing four quarters. The minimum interest coverage ratio covenant was 3.50 to 1 at March 31, 2005 and will remain at that level for all periods thereafter. Furthermore, we must maintain a tangible net worth of not less than \$205.8 million plus 75% of the cumulative consolidated net income for each fiscal quarter ending on or after June 30, 2004. As of March 31, 2005, the required tangible net worth was \$240.4 million. We are permitted to make capital expenditures under the Credit Facility in any fiscal year up to \$12.0 million, plus any unused carryover of up to \$10.0 million from prior years. As a result, we must limit our capital expenditures in 2005 to no more than \$17.2 million, which includes \$5.2 million of allowed carryover spending from prior years.

The Senior Notes also contain various restrictive covenants. We may not incur additional indebtedness unless we maintain a consolidated interest coverage ratio of at least 2.0 to 1.0 or unless the debt is otherwise permitted under the indenture. The consolidated interest coverage ratio measures the ratio of our EBITDA, as defined in the indenture relating to the Senior Notes, for the trailing four quarters to our interest expense for such quarters. Subject to specified exceptions, we may not make payments on or redeem our capital stock, make certain investments or make other restricted payments unless we maintain a consolidated interest coverage ratio of at least 2.0 to 1.0 and otherwise have available 50% of cumulative consolidated net income or capital stock sale proceeds from which such payments may be made. We are unable to incur liens unless expressly permitted under the Senior Notes or unless the Senior Notes are equally and ratably secured. We may not sell or otherwise dispose of any of the capital stock of our subsidiaries unless specifically authorized. We must receive fair market value for any asset sales and the consideration must be paid at least 75% in cash, cash equivalents or assumed liabilities. To the extent such proceeds are received, we must reinvest any proceeds exceeding \$10 million in additional assets within a period of 365 days or thereafter repay senior debt or repurchase Senior Notes. Additionally, we must repurchase the Senior Notes at a price equal to 101% of the principal amount of the Senior Notes upon a change of control. The indenture relating to the Senior Notes also contains additional covenants.

We are currently, and expect to remain, in compliance for at least the next twelve months in all material respects with the covenants in the Credit Facility and the Senior Notes.



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The following table presents a reconciliation of our EBITDA and Adjusted EBITDA, as defined in the Credit Facility, to net earnings for the trailing four quarters ended March 31, 2005:

<i>(In Thousands)</i>	<i>Second Quarter 2004</i>	<i>Third Quarter 2004</i>	<i>Fourth Quarter 2004</i>	<i>First Quarter 2005</i>	<i>Total</i>
Net earnings	\$ 13,465	10,021	9,706	13,000	46,192
Plus:					
Income tax expense	2,819	3,961	4,472	6,978	18,230
Interest expense	4,207	4,169	4,021	5,103	17,500
Depreciation and amortization expense	3,914	4,020	3,736	4,876	16,546
<b>EBITDA</b>	<b>24,405</b>	<b>22,171</b>	<b>21,935</b>	<b>29,957</b>	<b>98,468</b>
Noncash losses (gains)	615	(490)	(110)	(78)	(63)
<b>Adjusted EBITDA</b>	<b>\$ 25,020</b>	<b>21,681</b>	<b>21,825</b>	<b>29,879</b>	<b>98,405</b>

The Adjusted EBITDA calculation above is prepared in accordance with the terms of the Credit Facility. The noncash gains and losses, which are included in the Adjusted EBITDA calculation in accordance with the terms of the Credit Facility, may occur again. The depreciation and amortization expense above excludes debt issuance cost amortization. Adjusted EBITDA is presented solely to provide information on our debt covenants, and EBITDA and Adjusted EBITDA should not be considered an alternative to operating results or cash flows calculated in accordance with GAAP.

**Contractual Obligations.** With the exception of the \$82.2 million of new borrowings outstanding under the Credit Facility as of March 31, 2005, there have been no material changes in our contractual obligations as set forth in Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations - Contractual Obligations in our Annual Report on Form 10-K for the year ended December 31, 2004.

**New Accounting Pronouncements.** In December 2004, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards No. 123 (revised 2004), or SFAS 123R, Share-Based Payment, which replaces Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, and supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FAS 123. SFAS 123R addresses the accounting for share-based payment transactions in which a company receives employee services in exchange for either equity instruments of the company or liabilities that are based on the fair value of the company's equity instruments or that may be settled by the issuance of such equity instruments. SFAS 123R addresses all forms of share-based payment awards, including shares issued under employee stock purchase plans, stock options, restricted stock and stock appreciation rights. SFAS 123R eliminates the ability to account for share-based compensation transactions using the intrinsic method and generally would require that such transactions be accounted for using a fair-value-based method and recognized as expense over the period during which an employee is required to provide services in exchange for the award. SFAS 123R is effective for annual periods beginning after June 15, 2005. As such, we will implement the provisions of SFAS 123R effective January 1, 2006. We are in the process of evaluating the three allowable methods of transition to SFAS 123R but have not yet determined which method will be used. In 2006, we will incur compensation expense under SFAS 123R, as currently written, related to unvested options granted prior to January 1, 2006.



**Forward-Looking Statements**

This report contains certain forward-looking statements (as such term is defined in the Private Securities Litigation Reform Act of 1995) that are based on the beliefs of our management, as well as assumptions and estimates made by, and information currently available to, our management. When used in this report, the words anticipate, believe, estimate, expect, intend and similar expressions, as they relate to us or our management, identify forward-looking statements. Such statements reflect our current views with respect to future events and are subject to risks, uncertainties and assumptions relating to our operations and results of operations as well as those of our customers and suppliers, including as a result of competitive factors and pricing pressures, shifts in market demand, general economic conditions and other factors including, among others, those that effect flight activity in the commercial, business, government/military, and general/corporate aviation segments, the business activities of our customers and suppliers and developments in information and communication technology. Additional risks are set forth in our Annual Report on Form 10-K for the year ended December 31, 2004. Should one or more of these risks or uncertainties materialize, or should underlying assumptions or estimates prove incorrect, actual results may vary materially from those described in the forward-looking statements.

**Item 3: Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to market risk from changes in interest rates and foreign exchange rates. From time to time, we have used financial instruments to offset these risks. These financial instruments are not used for trading or speculative purposes. We did not experience any significant changes in market risk during the first three months of 2005. Our market risk is described in more detail in Item 7A: Quantitative and Qualitative Disclosures About Market Risk in our Annual Report on Form 10-K for the year ended December 31, 2004.

**Item 4: Controls and Procedures**

The term disclosure controls and procedures is defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, or the Exchange Act. This term refers to the controls and procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission. Our management, including our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this quarterly report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report.

There were no changes to our internal control over financial reporting during our first quarter of 2005 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**PART II - OTHER INFORMATION**
**Item 1: Legal Proceedings**

Not applicable.

**Item 2: Unregistered Sales of Equity Securities and Use of Proceeds**

The following table summarizes repurchases of our common stock in the quarter ended March 31, 2005:

<i>Period</i>	<i>Total Number of Shares Purchased(1)</i>	<i>Average Price Paid per Share</i>	<i>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</i>	<i>Maximum Number (or Approximate Dollar Value) of Shares that May Yet be Purchased Under the Plans or Programs</i>
January 1, 2005 - January 31, 2005	13,294	\$ 23.70		
February 1, 2005 - February 28, 2005		\$		
March 1, 2005 - March 31, 2005	1,993	\$ 28.31		
<b>Total</b>	<b>15,287</b>	<b>\$ 24.30</b>		

(1) The 15,287 total number of shares purchased were shares of restricted stock withheld for the payment of withholding taxes upon vesting of restricted stock.

**Item 3: Defaults Upon Senior Securities**

Not applicable.

**Item 4: Submission of Matters to a Vote of Security Holders**

Not applicable.

**Item 5: Other Information**

Not applicable.

**Item 6: Exhibits**

- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934
- 32.1 Certifications pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AVIALL, INC.

April 28, 2005

By:

/s/ COLIN M. COHEN  
**Colin M. Cohen**  
**Senior Vice President and Chief Financial Officer**  
**(Principal Financial Officer)**

**INDEX TO EXHIBITS**

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