AERO SYSTEMS ENGINEERING INC
Form 10-Q
August 06, 2001
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FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the quarterly period ended June 30, 2001

[ ] 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 0-7390

Aero Systems Engineering, Inc.
(Exact name of registrant as specified in its charter)

Minnesota	41-0913117
(State or other jurisdiction of incorporation or organization)	(I.R.S Employer Identification No.)

358 East Fillmore Avenue, St. Paul, Minnesota	55107
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code 651-227-7515

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 [X] No [ ]

As of June 30, 2001, 4,401,625 shares of common stock, par value $.20 per share, were outstanding.

AERO SYSTEMS ENGINEERING, INC.
(Subsidiary of Celsius Inc.)

Form 10-Q

Quarter Ended June 30, 2001

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

AERO SYSTEMS ENGINEERING, INC.
(Subsidiary of Celsius Inc.)
CONDENSED BALANCE SHEETS

ASSETS	June 30, 2001 (Unaudited)
	(000's omitted, except
CURRENT ASSETS	

Cash and cash equivalents	$ 25
Accounts Receivable, net	3,375
Costs and Estimated Earnings in Excess of Billings on Uncompleted Contracts	6,593
Inventories:	
Materials and Supplies	1,055
Projects in Process	620
Prepaid Expenses	50
Deferred and Prepaid Income Taxes	676
Total Current Assets	12,394
PROPERTY, PLANT AND EQUIPMENT	
Land	486
Buildings	3,025
Furniture, Fixtures, & Equipment	8,471
Wind Tunnels & Instrumentation	3,100
Building Improvements	1,489
	16,571
Less Accumulated Depreciation	11,803
Property, Plant, and Equipment, net	4,768
Total Assets	$17,162

AERO SYSTEMS ENGINEERING, INC.
(Subsidiary of Celsuis Inc.)
CONDENSED BALANCE SHEETS
(continued)

LIABILITIES	June 30, 2001 (Unaudited) (000's omitted, except
CURRENT LIABILITIES	
Current Maturities of Capital Lease Obligations	$ 40
Notes Payable	7,487
Accounts Payable:	
Trade	1,383
Affiliated Companies	105

Billings in Excess of Costs and Estimated Earnings on Uncompleted Contracts	817
Accrued Warranty and Losses	469
Accrued Salaries and Wages	970
Other Accrued Liabilities	997
Total Current Liabilities	12,268
OTHER LIABILITIES	
Deferred Income Taxes	570
Capital Lease Obligations, Less Current Maturities	103
Commitments and Contingencies	
STOCKHOLDERS' EQUITY	
Common Stock - Authorized 10,000,000 Shares of $.20 Par Value; Issued 4,401,625 on June 30, 2001 and December 31, 2000.	880
Additional Paid-in Capital	900
Retained Earnings	2,441
Total Stockholders' Equity	4,221
Total Liabilities and Stockholders' Equity	$17,162

Note: The balance sheet at December 31, 2000 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

AERO SYSTEMS ENGINEERING, INC.
(Subsidiary of Celsius, Inc.)

CONDENSED STATEMENTS OF EARNINGS
(Unaudited, 000's omitted)

	Three Months Ended June 30	
	2001	2000
Earned Revenue	$ 6,093	$ 8,078
Cost of Earned Revenue	4,447	6,246

Gross Profit	1,646	1,832
Operating Expenses	1,536	1,466
Operating Profit	110	366
Other Income (Expense)		
Interest Expense	(189)	(119)
Other	(17)	4
	(206)	(115)
Income (Loss) Before Income Taxes	(96)	251
Income Tax Expense	--	--
Net Income (Loss)	$ (96)	$ 251
NET INCOME (LOSS) PER SHARE	$ (0.02)	$ 0.06
Dividends per Share	None	None

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AERO SYSTEMS ENGINEERING, INC.
(Subsidiary of Celsius Inc.)
CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited, 000's omitted)

	Six
	2001
CASH FLOW FROM OPERATING ACTIVITIES:	
Net Income (Loss)	$ (379)
Adjustment to reconcile net income (loss) to net cash provided (used) by operating activities:	
Depreciation and Amortization	684
(Increase) Decrease in Assets:	
Accounts Receivable	2,986
Cost and Estimated Earnings in Excess of Billings on Uncompleted Contracts	(1,596)
Inventories	(192)
Prepaid Expenses	(2)

Increase (Decrease) in Liabilities:	
Accounts Payable and Accrued Expenses	(495)
Billings in Excess of Costs and Estimated Earnings on Uncompleted Contracts	(1,244)
Net Cash Provided (Used) by Operating Activities	(238)
CASH FLOW FROM INVESTING ACTIVITIES:	
Capital Expenditures	(268)
Net Cash Used in Investing Activities	(268)
CASH FLOW FROM FINANCING ACTIVITIES:	
Net Borrowings under Line of Credit Agreement	511
Principal Payments under Capital Lease Obligations	(28)
Net Cash Provided (Used) by Financing Activities	483
NET CHANGE IN CASH	(23)
CASH AT BEGINNING OF YEAR	48
CASH AT END OF QUARTER	$ 25

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AERO SYSTEMS ENGINEERING, INC.
(Subsidiary of Celsius Inc.)
NOTES TO CONDENSED FINANCIAL STATEMENTS
(Unaudited, 000's omitted)
June 30, 2001

NOTE A - BASIS OF PRESENTATION

The accompanying unaudited condensed financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting solely of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three-month and six-month periods ended June 30, 2001 are not necessarily indicative of the results that may be expected for the year ended December 31, 2001. For further information, refer to the financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2000.

NOTE B - DERIVATIVES AND HEDGING

The Company adopted Statement of Financial Accounting Standards ("SFAS") No. 133, Accounting for Derivative Instruments and Hedging

Activities, during the first quarter of 2001. In doing so, the Company did not incur any material transition adjustments. All derivatives are recognized on the balance sheet at their fair value. On the date a derivative contract is entered into, the derivative is designated as a fair value or cash flow hedge.

The Company formally documents all relationships between hedging instruments and the hedged items, as well as its risk-management objectives and strategy for undertaking various hedge transactions. The Company formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of the hedged items.

The Company uses foreign currency forward exchange contracts to hedge against the effect of exchange rate fluctuations on certain foreign currency denominated contracts.

NOTE C - CONTINGENCIES AND COMMITMENT

Guarantees of approximately $5,623,100 were outstanding on June 30, 2001 to various customers as bid bonds or in exchange for down payments or warranty performance bonds.

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AERO SYSTEMS ENGINEERING, INC.
(Subsidiary of Celsius Inc.)
NOTES TO CONDENSED FINANCIAL STATEMENTS
(Unaudited, 000's omitted)
June 30, 2001

NOTE D - CONTRACTS IN PROCESS

Information with respect to contracts in process follows:

	June 30, 2001
Costs Incurred on Uncompleted Contracts	$49,355
Estimated Earnings Thereon	14,625
Total Earned Revenue on Uncompleted Contracts	63,980
Less Billings Applicable thereto	58,204
	$ 5,776

Included in Accompanying Balance Sheet
Under Following Captions:
Costs and Estimated Earnings in Excess of

Billings on Uncompleted Contracts	$ 6,593
Billings in Excess of Costs and Estimated Earnings on Uncompleted Contracts	817
	$ 5,776

AERO SYSTEMS ENGINEERING, INC.
(A Subsidiary of Celsius Inc.)

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

Financial Condition

Second quarter 2001 (All dollar amounts are in thousands.)

Worldwide revenue for the second quarter 2001 totaled $6,093, which was a 25% decrease from $8,078 in the second quarter of last year. Net loss for the second quarter was $96 as compared to second quarter net income of $251 for the same period last year.

Backlog of orders as of June 30, 2001 was $27,303 as compared with $27,710 and $36,063 as of December 31, 2000 and June 30, 2000, respectively. The change from December 31, 2000 represents a 1% decrease. The change from June 30, 2000 is mostly related to the conversion of backlog into revenue for the $23,000 order received in June 2000 for the supply of a wind tunnel in Singapore.

The revenue decrease was mostly attributable to the delay of U.S. government approval of the export license application for the wind tunnel project in Singapore. The export license was submitted for approval during the fourth quarter of 2000, and as of the date of this Form 10-Q, the Company believes that the export license will be received shortly. Due to this delay, work on the project has been very limited, resulting in lower revenue and margin recognition. The loss in the second quarter was also partially the result of increased interest expense due to the higher line of credit balance.

Cost of earned revenue for the second quarter, which includes manufacturing and engineering costs, was 73% of revenue as compared to 77% during the same period of last year. This decrease is mostly the result of improved project margins on the wind tunnels and Aerotest Lab projects during the second quarter.

The Company recognizes revenue using the percentage of completion method for its long-term contracts. Estimates of revenues earned and expenses to be incurred to complete the contracts are made in conjunction with the preparation of the quarterly financial statements. However, final determination of the profitability of the contracts are subject to settlement of any final claims which may develop at the time the completed contract is accepted by the customer as well as risks inherent in estimates which are made during the course of the contract work.

Selling, general and administrative expenses of $1,399 were 23% of revenues during the second quarter of 2001 as compared to $1,116 and 14% of revenues during the same period of last year. This increase of $283 or 25% was primarily related to the additional marketing staff added at the end of 2000 and the increase in bid and proposal activities related to several new proposals.

Research and development expenses were $137 during the second quarter of 2001 as compared to $350 in the same period in 2000. This decrease of $213 or 61% is mostly related to the focus of certain resources in the second quarter 2001 on project and proposal work rather than on R&D activities. During 2001, additional research and development expenses will be incurred for continued enhancements to the ASE2000, aero-acoustic analysis and new product initiatives.

Interest expense of $189 was incurred during the second quarter of 2001, as compared to $119 from the same period in 2000. The average rate of interest on short-term borrowings has had little change, while the average amount of borrowings outstanding has increased in the second quarter as compared to the second quarter of last year.

Capital expenditures for the second quarter of 2001 were $152 as compared to $75 for the same period last year. This increase of $77 is attributed to the acquisition of new shop and R&D equipment. Additional capital expenditures will be used to acquire additional equipment for research and development projects, facility improvements and desktop upgrades.

Accounts receivable at the end of the second quarter 2001 was $3,375 as compared with the year end 2000 balance of $6,361. This decrease of $2,986 was due mainly to invoice timing on several large contracts.

Costs and estimated earnings in excess of billings on uncompleted contracts at the end of the second quarter of 2001 increased $1,596, or 32%, to $6,593 as compared with the balance at December 31, 2000. The Company recognizes profit on long-term projects on the percentage of completion basis, which permits earned revenue to be recognized prior to the time that progress payments are billed. When this occurs, amounts are added to this asset account for the recognition of earned revenue prior to the billing of progress payments. The increase since year-end is mostly due to the delay of billing milestones on the Singapore wind tunnel project as a result of the delay in receiving the export license. Billings are a function of contract terms and do not necessarily relate to the percentage of completion of a project.

Notes payable balance was $7,487 at the end of the second quarter 2001 as compared to the year end balance of $6,976, which is an increase of $511 or 7%. This increase is primarily the result of the delay in achieving billing milestones on the Singapore wind tunnel project as a result of the delay of receipt of the export license.

Accounts payable and accrued expenses at the end of the second quarter decreased $495 or 11% as compared to the year end balance. This was primarily due to a decrease in accrued job costs relating to ongoing projects.

Billings in excess of costs and estimated earnings on uncompleted contracts decreased $1,244, or 60%, to $817 as compared with the balance at December 31, 2000. The decrease since year-end is due to the timing of billing milestones related to the contracts. Billings are a function of contract terms and do not necessarily relate to the percentage of completion of a project.

The Company operates on a global basis, and, during an average year, it generates approximately 50% of its revenues from international customers. This trend has continued for the last five years as foreign airlines and government agencies purchase products that ASE designs and produces. Most of the Company's contracts are denominated in U.S. dollars. However, a few of them are denominated in the customer's local currency. Therefore, the Company has entered into several foreign exchange forward contracts having maturities within the next eighteen months. The face amounts represent U.S. dollar equivalents of a non-U.S. dollar denominated forward contract. The amounts at risk are not material and the Company should have the financial ability to generate cash flows to offset the expected gain or losses when the contracts mature.

The Company has consistently relied upon bank credit lines during recent years as a source of its working capital resources and liquidity. Funds under these lines of credit are actually provided by Celsius Inc. and ultimately are guaranteed by Saab AB. Celsius Inc., a United States corporation, is a wholly-owned subsidiary of Saab AB. Celsius Inc. owns approximately 80% of the outstanding shares of common stock of the Company. A first security interest in all assets of the Company has been granted to Celsius Inc., and a fee is paid through Celsius Inc.

ASE currently has a bank line of credit, which enables it to borrow up to a total of $6,000. As of June 30, 2001, $7,487 was used. Although the line of credit has a $6,000 limit, Celsius Inc. has allowed the Company to exceed this limit for short periods of time. The portion over $6,000 is assessed a higher interest rate of 10%. The Company believes that these bank lines of credit, along with cash flows from continuing operations, are adequate to support the Company's cash needs for the immediate future.

Highly competitive market conditions have minimized the margins on new contracts. Productivity improvements and cost reduction programs are continually being initiated to increase margins.

Looking ahead throughout the remainder of 2001, the expected receipt of the Singapore export license, the amount of business in backlog and the number of proposals outstanding should provide a solid base for the remainder of the year.

PART II - OTHER INFORMATION

Item 6: Exhibits and Reports on Form 8-K

(a) No exhibits are included in this filing.

(b) No Current Reports on Form 8-K were filed during the quarter ended June 30, 2001, or during the period from June 30, 2001 to the date of filing of this quarterly report on Form 10-Q.

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 thereto duly authorized.

Date: August 6, 2001

/s/ Charles Loux

Charles Loux, President and CEO

/s/ Steven R. Hedberg

Steven R. Hedberg, Chief Financial Officer