AERO SYSTEMS ENGINEERING INC
Form 10-Q
May 14, 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 March 31, 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 March 31, 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 March 31, 2001

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

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

ASSETS	March 31, 2001

	(Unaudited) (000's omitted, except
CURRENT ASSETS	
Cash and cash equivalents	$ 26
Accounts Receivable, net	4,243
Costs and Estimated Earnings in Excess of Billings on Uncompleted Contracts	6,423
Inventories:	
Materials and Supplies	1,201
Projects in Process	564
Prepaid Expenses	56
Deferred and Prepaid Income Taxes	676
Total Current Assets	13,189
PROPERTY, PLANT AND EQUIPMENT	
Land	486
Buildings	3,025
Furniture, Fixtures, & Equipment	8,390
Wind Tunnels & Instrumentation	3,029
Building Improvements	1,489
	16,419
Less Accumulated Depreciation	11,461
Property, Plant, and Equipment, net	4,958
Total Assets	$ 18,147

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

LIABILITIES	March 31, 2001 (Unaudited) (000's omitted
CURRENT LIABILITIES	
Current Maturities of Capital Lease Obligations	$ 40
Notes Payable	6,709
Accounts Payable:	

Trade	1,407
Affiliated Companies	52
Billings in Excess of Costs and Estimated Earnings on Uncompleted Contracts	1,966
Accrued Warranty and Losses	472
Accrued Salaries and Wages	959
Other Accrued Liabilities	1,545
Total Current Liabilities	13,150
OTHER LIABILITIES	
Deferred Income Taxes	570
Capital Lease Obligations, Less Current Maturities	110
Commitments and Contingencies	
STOCKHOLDERS' EQUITY	
Common Stock - Authorized 10,000,000 Shares of $.20 Par Value; Issued 4,401,625 on March 31, 2001 and December 31, 2000.	880
Additional Paid-in Capital	900
Retained Earnings	2,537
Total Stockholders' Equity	4,317
Total Liabilities and Stockholders' Equity	$ 18,147

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.

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

	Three
	2001
Earned Revenue	$ 5,739
Cost of Earned Revenue	4,396

Gross Profit	1,343
Operating Expenses	1,403
Operating Profit(Loss)	(60)
Other Income (Expense)	
Interest Expense	(227)
Other	4
	(223)
Income (Loss) Before Income Taxes	(283)
Net Income (Loss)	$ (283)
NET INCOME (LOSS) PER SHARE	$ (0.06)
Dividends per Share	None

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

	Three
	2001
CASH FLOW FROM OPERATING ACTIVITIES:	
Net Income (Loss)	$ (283)
Adjustment to reconcile net income (loss) to net cash provided (used) by operating activities:	
Depreciation	342
(Increase) Decrease in Assets:	
Accounts Receivable	2,118
Cost and Estimated Earnings in Excess of Billings on Uncompleted Contracts	(1,426)
Inventories	(282)
Prepaid Expenses	(8)
Increase (Decrease) in Liabilities:	
Accounts Payable and Accrued Expenses	16
Billings in Excess of Costs and Estimated Earnings on Uncompleted Contracts	(95)

Net Cash Provided (Used) by Operating Activities	382
CASH FLOW FROM INVESTING ACTIVITIES:	
Capital Expenditures	(116)
Net Cash Used in Investing Activities	(116)
CASH FLOW FROM FINANCING ACTIVITIES:	
Net Borrowings under Line of Credit Agreement	(267)
Principal Payments under Capital Lease Obligations	(21)
Net Cash Used by Financing Activities	(288)
NET CHANGE IN CASH	(22)
CASH AT BEGINNING OF YEAR	48
CASH AT END OF QUARTER	$ 26

AERO SYSTEMS ENGINEERING , INC.
(Subsidiary of Celsius Inc.)
NOTES TO CONDENSED FINANCIAL STATEMENTS
(Unaudited, 000's omitted)
March 31, 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 period ending March 31, 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.

Certain prior year balances have been reclassified to conform to the current quarter's presentation.

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 $5,139,840 were outstanding on March 31, 2001 to various customers as bid bonds or in exchange for down payments or warranty performance bonds.

AERO SYSTEMS ENGINEERING , INC.
(Subsidiary of Celsius Inc.)
NOTES TO CONDENSED FINANCIAL STATEMENTS (CONTINUED)
(Unaudited, 000's omitted)
March 31, 2001

NOTE D - CONTRACTS IN PROCESS

Information with respect to contracts in process follows:

	March 31, 2001
Costs Incurred on Uncompleted Contracts	$ 45,719
Estimated Earnings Thereon	12,923
Total Earned Revenue on Uncompleted Contracts	58,642
Less Billings Applicable thereto	54,185
	$ 4,457

Included in Accompanying Balance Sheet Under Following Captions:	
Costs and Estimated Earnings in Excess of Billings on Uncompleted Contracts	$ 6,423
Billings in Excess of Costs and Estimated Earnings on Uncompleted Contracts	1,966
	$ 4,457

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

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

Worldwide revenue for first quarter 2001 totaled $5,739, which was a 15% decrease from $6,760 in first quarter of last year. Net loss for first quarter was $283 as compared to the first quarter loss of $466 last year.

Backlog of orders as of March 31, 2001 was $26,215 as compared with $27,710 and $18,619 as of December 31, 2000 and March 31, 2000, respectively. This 41% increase from first quarter 2000 is mostly the result of the receipt of a major wind tunnel order from a customer in Singapore during the second quarter of 2000, causing a significant increase to backlog.

The revenue decrease was mostly attributable to the delay and the uncertainty of U.S. government approval of the export license application for the major wind tunnel project for a customer in Singapore. The export license was submitted for approval during the fourth quarter of 2000, and at the time of this filing, the Company remains optimistic that the export license will ultimately be granted. Due to this delay, work on the project has been very limited, resulting in lower revenue and margin recognition. The loss in the first quarter was also partially the result of increased interest expense due to the higher line of credit balance.

Cost of earned revenue for first quarter, which includes manufacturing and engineering costs, was 77% of revenue as compared to 79% 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 first quarter 2001.

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 $1,296 were 23% of revenues during first quarter 2001 as compared to $1,562 and 23% during the same period of last year. This decrease of $266 is the result of lower bid and proposal activities in first quarter 2001 as compared to first quarter 2000. Bid and proposal costs in the first quarter 2000 were significantly higher than typically expended in a quarter due to the timing of a couple of large proposal submissions.

Research and development expenses were $107 during first quarter of 2001 as compared to $196 in the same period in 2000. This decrease of $89 or 45% is mostly related to the focus of certain resources in first quarter 2001 on project work rather than on R&D activities. During 2001, additional R & D will be incurred for continued enhancements to the ASE2000, aero-acoustic analysis and new product initiatives.

Interest expense of $227 was incurred during the quarter as compared to $101 from the same period in the prior year. The average rate of interest on short-term borrowings has had little change, while the average amount of borrowings outstanding has increased in the first quarter as compared to the first quarter of last year.

Capital expenditures were $116 as compared to $60 for the same period of last year. This increase of $56 is attributed to the acquisition of new test and calibration 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 first quarter was $4,243 as compared with the year end balance of $6,361. This decrease of $2,118 was due mainly to the collection of several large invoices outstanding at the end of 2000.

Costs and estimated earnings in excess of billings on uncompleted contracts at the end of first quarter was $6,423, which is an increase of $1,426 or 29% as compared with the year-end 2000 balance. 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 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.

Notes payable balance was $6,709 as compared to the year end balance of $6,976, which is a decrease of $267 or 4%. This decrease is primarily the result of timing of project expenditures as compared to invoicing milestones.

Accounts payable and accrued expenses at the end of first quarter 2001 increased $16 or less than 1% as compared to the year end 2000 balance. This was primarily due to an increase in accrued job costs relating to ongoing projects.

Billings in excess of costs and estimated earnings on uncompleted contracts at the end of first quarter decreased $95 to $1,966 compared to the year-end 2000 balance of $2,061. The decrease since year-end is due to the timing of billing milestones related to 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, 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 has the financial ability to generate cash flows to offset the expected gains 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 ASE. A first security interest in all assets of ASE has been granted to Celsius Inc., and a fee is paid through Celsius Inc.

Prior to the first quarter 2000, Celsius Inc., a U.S. company, was a wholly owned subsidiary of Celsius AB, a Swedish company, but is now ultimately owned by Saab AB, also a Swedish company. During the fourth quarter of 1999, Saab AB issued a tender offer to acquire all of the outstanding shares of Celsius AB. Saab AB completed the acquisition of Celsius AB during March 2000.

ASE currently has a bank line of credit, which enables it to borrow up to a total of $6,000. As of March 31, 2001, $6,709 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 11%. 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 approval 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.

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

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 March 31, 2001, or during the period from March 31, 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: May 14, 2001

/s/ Charles Loux

Charles Loux, President and CEO

/s/ Steven R. Hedberg

Steven R. Hedberg, Chief Financial Officer