

AEROSONIC CORP /DE/
Form 10-Q/A
December 08, 2004

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

FORM 10-Q/A

Amendment No. 1

(Mark One)

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

For the quarterly period ended April 30, 2004

OR

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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 1-11750

AEROSONIC CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

74-1668471
I.R.S. Employer Identification No.)

1212 North Hercules Avenue

Clearwater, Florida 33765

(Address of principal executive offices and Zip Code)

Registrant's telephone number, including area code: (727) 461-3000

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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 Act). Yes No

As of November 30, 2004, the issuer had 3,921,019 shares of Common Stock outstanding, net of treasury shares.

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EXPLANATORY NOTE

Aerosonic Corporation (the **Company**) is filing this Amendment No. 1 to its Quarterly Report on Form 10-Q for its fiscal quarter ended April 30, 2004, as filed with the Securities and Exchange Commission on June 2, 2004 (the "**Original April 2004 Form 10-Q**"), primarily to correct an error in recording income taxes receivable and deferred income taxes in the fiscal year ended January 31, 2000, as carried on the balance sheet for each subsequent period through April 30, 2004 (the **Income Tax Error**), and to correct the resulting effects upon total assets, retained earnings, and shareholders' equity.

The Company erroneously recorded income taxes receivable resulting from tax refunds expected from the application of net operating loss carrybacks to tax years ended January 31, 1998 and 1999, for which the applicable statutes of limitations had expired. The prior period adjustment to correct the Income Tax Error results in a reduction of approximately \$572,000 in income taxes receivable, total assets, retained earnings and shareholders' equity, as of January 31, 2000 and at each subsequent year end. These adjustments, as reflected in this Amendment No. 1, do not affect earnings or cash flows in the Company's previously reported financial statements for the fiscal quarters ended April 30, 2004 or 2003, as included in its Original April 2004 Form 10-Q.

Actual Changes in the Original April 2004 Form 10-Q. The actual changes in the Original April 2004 Form 10-Q included in this Amendment No. 1 are amendments to Part I that include: **(a)** amended and restated Consolidated Balance Sheets as at April 30, 2004 and January 31, 2004, **(b)** a new Note 2 discussing the restatement of prior years financial statements resulting from the Income Tax Error **(c)** changes in the Financial Statement Note number references in Part I (due to the renumbering of the Notes because of the inclusion of new Note 2), **(d)** an expansion of Note 5 to announce a recent event involving the SEC investigation and provide an update of developments in the securities class action litigation, **(e)** an updated Note 6 to the Financial Statements, and **(f)** an expansion of Note 7 to add a third paragraph discussing the notice of the Income Tax Error and the restatement of the April 30, 2004 and January 31, 2004 Consolidated Balance Sheets; and amendments to Part II Item 1 that include: **(a)** the above mentioned announcement of a recent event involving the SEC investigation and update of developments in the securities class action litigation, and **(b)** a discussion of recent action by the SEC.

Notwithstanding that there are no changes in the Consolidated Statements of Operations for the quarters ended April 30, 2004 and 2003, the Consolidated Statements of Cash Flows for the quarters ended April 30, 2004 and 2003, or most of the Notes to the Financial Statements included in this Amendment No. 1, a complete Form 10-Q document including a complete set of the Financial Statements (together with all of the Notes) has been included in this Amendment No. 1, for convenient reference.

PART I FINANCIAL INFORMATION

Forward-Looking Statements

THIS DOCUMENT INCLUDES CERTAIN FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995. THESE FORWARD-LOOKING STATEMENTS INCLUDE, BUT ARE NOT LIMITED TO OUR PLANS, OBJECTIVES, EXPECTATIONS AND INTENTIONS AND OTHER STATEMENTS CONTAINED IN THIS REPORT THAT ARE NOT HISTORICAL FACTS AS WELL AS STATEMENTS IDENTIFIED BY WORDS SUCH AS EXPECTS, ANTICIPATES, INTENDS, PLANS, BELIEVES, SEEKS, ESTIMATES OR OF SIMILAR MEANING. THESE STATEMENTS ARE BASED ON OUR CURRENT BELIEFS OR EXPECTATIONS AND ARE INHERENTLY SUBJECT TO SIGNIFICANT UNCERTAINTIES AND CHANGES IN CIRCUMSTANCES, MANY OF WHICH ARE BEYOND OUR CONTROL. ACTUAL RESULTS MAY DIFFER MATERIALLY FROM THESE EXPECTATIONS DUE TO CHANGES IN GLOBAL POLITICAL, ECONOMIC, BUSINESS, COMPETITIVE, MARKET AND REGULATORY FACTORS.

Significant Events.

On February 25, 2004, Aerosonic Corporation (the **Company**) refinanced all of its short-term and long-term bank debt obligations with Wachovia Bank, N.A. Note 5 of Item 1 of Part I includes a discussion of the nature and certain details of the debt refinancing.

Note 6 of Item 1 of Part 1 and Item 1 of Part II of this report include discussions of: (i) an investigation by the U.S. Securities and Exchange Commission regarding certain accounting issues, and (ii) securities class action lawsuits filed against the Company, PricewaterhouseCoopers LLP, The Company's former independent accountant, and four former employees of the Company, two of whom were directors.

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Item 1 Financial Statements

AEROSONIC CORPORATION AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

	Three Months ended April 30,	
	2004	2003
Revenue, net		
	\$ 7,096,000	\$ 8,744,000
Cost of sales		
	5,088,000	5,831,000
Gross profit		
	2,008,000	2,913,000
Selling, general and administrative expenses		
	1,779,000	2,343,000
Operating income		
	229,000	570,000
Other income (expense):		
Interest expense, net		
	(6,000)	(53,000)
Miscellaneous income		
	121,000	3,000
	115,000	(50,000)

Income before income taxes		
	344,000	520,000
Income tax expense		
	(135,000)	(17,000)
Net income		
	\$ 209,000	\$ 503,000
Basic and diluted earnings per share		
	\$ 0.05	\$ 0.13
Basic and diluted weighted average shares outstanding		
	3,921,019	3,921,019

The accompanying notes are an integral part of these condensed consolidated financial statements

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**AEROSONIC CORPORATION AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS**

	April 30, 2004 (unaudited) as restated	January 31, 2004 (audited) as restated
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 296,000	\$ 1,276,000
Receivables, net of allowance for doubtful accounts of \$152,000 and \$152,000	4,281,000	3,896,000
Income tax receivable	580,000	1,270,000
Costs and estimated profits in excess of billings	2,025,000	1,398,000
Inventories	5,478,000	5,683,000
Prepaid expenses	221,000	190,000
Deferred income taxes	559,000	559,000
Total current assets	13,440,000	14,272,000
Property, plant and equipment, net	3,862,000	3,954,000
Deferred income taxes	38,000	38,000

Capitalized software costs and other assets, net	223,000	127,000
Total assets	\$ 17,563,000	\$ 18,391,000

LIABILITIES AND STOCKHOLDERS EQUITY

Current liabilities:		
Long-term debt and notes payable due within one year	\$ 259,000	\$ 200,000
Revolving credit facilities	945,000	1,000,000
Accounts payable, trade	1,283,000	2,910,000
Compensation and benefits	930,000	779,000
Income taxes payable	135,000	-
Accrued expenses and other liabilities	2,076,000	2,343,000
Total current liabilities	5,628,000	7,232,000
Long-term debt and notes payable due after one year	2,783,000	2,216,000
Total liabilities	8,411,000	9,448,000
Commitments and contingencies		
Stockholders equity:		
Common stock \$.40 par value: authorized 8,000,000; shares		
issued 3,986,262; shares outstanding 3,921,019	1,595,000	1,595,000
Additional paid-in capital	4,559,000	4,559,000

Retained earnings		
	3,694,000	3,485,000
Less treasury stock: 65,243 shares at April 30, 2004 and January 31, 2004, at cost		
	(696,000)	(696,000)
Total stockholders' equity	9,152,000	8,943,000
Total liabilities and stockholders' equity	\$ 17,563,000	\$ 18,391,000

The accompanying notes are an integral part of these condensed consolidated financial statements

Table of Contents**AEROSONIC CORPORATION AND SUBSIDIARY****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)**

	Three Months ended April 30,	
	2004	2003
Cash flow from operating activities:		
Net income		
	\$ 209,000	\$ 503,000
Adjustments to reconcile net income to net cash provided by/ (used in) operating activities:		
Depreciation	163,000	221,000
Amortization	2,000	61,000
Deferred income taxes	-	(181,000)
Changes in assets and liabilities:		
Receivables	(385,000)	396,000
Income taxes receivable and payable	825,000	417,000
Costs and estimated profits in excess of billings	(627,000)	(853,000)
Inventories	205,000	(102,000)
Prepaid expenses	(31,000)	(29,000)

Capitalized software costs and other assets		
	(96,000)	(80,000)
Accounts payable, trade		
	(1,627,000)	134,000
Compensation and benefits		
	151,000	44,000
Accrued expenses and other liabilities		
	(267,000)	910,000
Net cash provided by/(used in) operating activities		
	(1,478,000)	1,441,000
Cash flow from investing activities:		
Capital expenditures		
	(73,000)	(141,000)
Net cash used in investing activities		
	(73,000)	(141,000)
Cash flow from financing activities:		
Proceeds/(payments) from revolving credit facilities		
	(55,000)	170,000
Proceeds from issuance of long-term debt		
	626,000	-
Principal payments on long-term debt and notes payable		
	-	(230,000)
Net cash provided by/(used in) financing activities		
	571,000	(60,000)
Net increase/(decrease) in cash and cash equivalents		
	(980,000)	1,240,000
Cash and cash equivalents at beginning of period	1,276,000	260,000

Cash and cash equivalents at end of period

\$	296,000	\$	1,500,000
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Supplemental disclosure of cash flow information:

Cash paid during the period for:

Interest

\$	47,000	\$	42,000
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Income taxes

-	14,000
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Non cash investing and financing activities:

Debt refinance

\$	3,326,000	\$	-
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Acquisition of property under a capital lease

\$	-	\$	45,000
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The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents**AEROSONIC CORPORATION AND SUBSIDIARY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)****Note 1 Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements of Aerosonic Corporation (the **Company**) have been prepared in accordance with generally accepted accounting principles for interim financial reporting and with the instructions to Form 10-Q and in Regulation S-X of the U.S. Securities and Exchange Commission (**SEC**). Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The restated January 31, 2004 consolidated balance sheet has been derived from the audited consolidated financial statements that the Company has amended (as described in Note 2 and Note 7), but does not include all of the disclosures required by generally accepted accounting principles. The financial statements are prepared on a consistent basis (including normal recurring adjustments) and should be read in conjunction with the impact of the amendment described in Note 6 upon the audited consolidated financial statements and related notes contained in the Annual Report on Form 10-K/A for the fiscal year ended January 31, 2004 (the **2004 Form 10-K/A**) that the Company filed with the SEC on December 7, 2004. Operating results for the three months ended April 30, 2004 are not necessarily indicative of the results that may be expected for the year ended January 31, 2005.

Note 2 - Restatement of Prior Periods Financial Statements

In September 2004, the Company announced that the United States Internal Revenue Service (**IRS**) had disallowed the Company's income tax refund claims of approximately \$873,000 for the tax years ended January 31, 1998 and 1999. The Company had erroneously recorded income taxes receivable for the tax effect of net operating loss carry backs to tax years for which the applicable statutes had expired. The Company has since filed an amended return for the tax year ended January 31, 2001 that resulted in a refund of approximately \$301,000. The prior period adjustment to correct this error results in the reduction of income taxes receivable and retained earnings by approximately \$572,000 at January 31, 2000 and thereafter and an increase in income tax expense of approximately \$572,000 for the year ended January 31, 2000. This adjustment has been made to income tax receivable and retained earnings in each reporting period. This amendment does not affect earnings or cash flows in the Company's previously reported financial statements in the Company's Original 2005 Form 10-Q.

The following table presents the impact of this adjustment on our previously reported balance sheets as of April 30, 2004 and January 31, 2004:

April 30, 2004 (unaudited)	January 31, 2004 (audited)
as Restated	as Restated

	Previously Reported		Previously Reported	
BALANCE SHEET:				
Income taxes receivable				
	\$ 1,152,000	\$ 580,000	\$ 1,842,000	\$ 1,270,000
Deferred income taxes				
	619,000	559,000	619,000	559,000
Total current assets				
	14,072,000	13,440,000	14,904,000	14,272,000
Deferred income taxes				
	-	38,000	-	38,000
Total Assets				
	\$ 18,157,000	\$17,563,000	\$18,985,000	\$18,391,000
Deferred income taxes				
	22,000	-	22,000	-
Total liabilities				
	8,433,000	8,411,000	9,470,000	9,448,000
Total stockholders' equity				
	\$ 9,724,000	\$ 9,152,000	\$ 9,515,000	\$ 8,943,000
Total liabilities and stockholders' equity				
	\$ 18,157,000	\$17,563,000	\$18,985,000	\$18,391,000

Note 3 Business

The Company is principally engaged in one business segment: The manufacture and service of aircraft instruments. The Company consists of four operating divisions in three locations. The divisions are: the Clearwater, Florida Instrument Division (**Clearwater Instruments**), the Aerosonic Wichita, Kansas Division (**Kansas Instruments**), Avionics Specialties, Inc., a Virginia corporation wholly owned by the Company (**Avionics**), and the Precision Component Division (**Precision Components**).

Clearwater Instruments primarily manufactures altimeters, airspeed indicators, rate of climb indicators, microprocessor controlled air data test sets, and a variety of other flight instrumentation. Kansas Instruments is the source inspection location for our Wichita customers and is the primary location for Clearwater Instruments repair business. Avionics maintains three major product lines: (1) angle of attack stall warning systems; (2) integrated multifunction probes, which are integrated air data sensors; and (3) other aircraft sensors and monitoring systems. In August 1998, the Company formed a new division called Precision Components, to perform high volume precision machining of mechanical components, which was less than 10% of operations during the three months ended April 30, 2004 and 2003.

During the three months ended April 30, 2004, sales to Lockheed represented approximately 20% of total revenues.

The Company has a January 31 fiscal year end. Accordingly, all references in this quarterly report on Form 10-Q to the first quarter mean the first quarter ended on April 30 of the referenced fiscal year. For example, references to the first quarter of fiscal year 2005 mean the first quarter ended April 30, 2004.

Note 4 Inventories

Inventories are stated at the lower of cost or market. Cost is determined using a method that approximates the first-in, first-out method. Provisions are made for any inventory deemed excess or obsolete. Management employs certain methods to estimate the value of work in process inventories for financial reporting purposes. At fiscal year end, these estimates are affected by the nature of the operation at which the items are located and the time at which a physical inventory is conducted, and are subject to judgment. This practice was employed for the fiscal year ended January 31, 2004. For interim reporting periods, the Company utilizes monthly work in process inventory reports to estimate the value of such inventories.

Inventories at April 30, 2004 and January 31, 2004 consisted of the following:

	April 30, 2004	January 31, 2004
Raw materials	\$ 3,359,000	\$ 3,756,000
Work in process	2,019,000	1,719,000
Finished goods	100,000	208,000
	\$ 5,478,000	\$ 5,683,000

Note 5 Long Term Debt and Notes Payable

The Company completed a refinancing of its existing debt with Wachovia Bank, N.A. (**Wachovia**) on February 25, 2004. The new facilities total approximately \$5.7 million, and include a 15 year term loan of approximately \$3.0 million that is collateralized by the Company's real estate in Clearwater, Florida, a revolving credit facility of approximately \$2.5 million, and a seven year equipment loan of approximately \$0.2 million. These facilities replace all of the Company's debt that was previously held by First Commercial Bank and SunTrust Bank, N.A.

Long term debt and notes payable at April 30, 2004 and January 31, 2004 consisted of the following:

	April 30, 2004	January 31, 2004
Mortgage note payable Wachovia	\$ 2,983,000	\$ -
Note payable	-	717,000
Industrial development revenue bonds	-	668,000
Mortgage note payable SunTrust	-	391,000
Note payable, equipment	-	205,000
Note payable, II	-	53,000
Capitalized leases	59,000	82,000
	3,042,000	2,416,000
Less current maturity	259,000	1,497,000

Long-term debt and notes payable, less current maturity

	\$	
2,783,000	\$	919,000

Covenants

The Company's long-term debt agreements with Wachovia contain certain financial and other restrictive covenants, including the requirement to maintain: (i) at all times, a ratio of total liabilities to tangible net worth that does not exceed 1.30 to 1.00; and (ii) at the end of each fiscal quarter, a cash flow coverage ratio (with regard to the debt service) of at least 1.25 to 1.00. As of April 30, 2004, the Company was in compliance with these financial covenants.

The Wachovia loan agreement subjects the Company to a number of additional covenants that, among other things, require the Company to obtain consent from the lender prior to making a material change of management, guarantee or otherwise become responsible for obligations of any other person or entity or assuming or becoming liable for any debt, contingent or direct, in excess of \$100,000.

The Company's ability to maintain sufficient liquidity and compliance with covenants in fiscal year 2005 and beyond is highly dependent upon achieving expected operating results. Failure to achieve expected operating results and compliance with covenants could have a material adverse effect on the Company's liquidity and operations in fiscal year 2005 and beyond, and could require implementation of further measures, including deferring planned capital expenditures, reducing discretionary spending, and/or, if necessary, selling assets.

Note 6 Commitments and Contingencies

In accordance with a consent agreement with the Department of Environmental Protection signed by the Company in 1993, the Company's environmental consultant has developed an interim remedial action plan to contain and remediate certain contamination on and underlying the Company's property in Clearwater, Florida. During 1997, the Company recorded a provision of approximately \$175,000 related to the estimated costs to be incurred under this plan. As of January 31, 2000, the Company had utilized all amounts originally recorded in other accrued expenses, and Phase I remediation had been completed.

During the third quarter of 2001, management determined the post-remediation monitoring expense related to the environmental cleanup of 1993 would cost approximately \$125,000. This amount was accrued and expensed during the third quarter of 2001. As of January 31, 2004, all existing reserve balances had been utilized. Based upon information provided by the Company's environmental consultants, management estimates that the Company will incur post-remediation monitoring expenses of approximately \$38,000, for which a reserve has been established as of January 31, 2004.

The Company's contractual obligations for future minimum payments under our long-term debt and operating leases as of April 30, 2004 are as follows:

Contractual Obligations	Total	<u>Payments Due by Period</u>			
		Less than One Year	1 - 3 years	4 - 5 years	> 5 years
Purchase commitments	\$ 6,703,000	\$ 6,227,000	\$ 458,000	\$ 18,000	\$ -
Long-term debt	3,042,000	259,000	600,000	400,000	1,783,000
Operating leases	1,116,000	398,000	718,000	-	-
Total	\$10,861,000	\$ 6,884,000	\$ 1,776,000	\$ 418,000	\$ 1,783,000

The Company is the subject of a Formal Order of Investigation issued by the U.S. Securities and Exchange Commission (the **SEC**) on May 13, 2003 with respect to potential violations of the federal securities laws in connection with the accounting misstatements and contributing causes disclosed by the Company in press releases dated March 17 and May 22, 2003 and further discussed in the Company's annual report for the fiscal year ended January 31, 2003 and the subsequent quarterly reports on Form 10-Q, which the Company brought to the attention of the SEC in conjunction with management's internal investigation, and other potential issues. The Company received a letter from the SEC dated October 27, 2004 advising the Company that the SEC investigation has been terminated as to the Company and that no enforcement action has been recommended to the Commission, as to the Company. See Part II Item 1 below under the caption "SEC Formal Investigation and Action Against Former Executives" with this same discussion and additional information as to actions taken by the SEC.

On November 12, 2003, a class action lawsuit was filed in the United States District Court for the Middle District of Florida by Sebastian P. Gaeta, individually and on behalf of all other similarly situated (the **Gaeta Suit**), against the Company, PricewaterhouseCoopers LLP, the Company's former independent accountant, J. Mervyn Nabors, a former director and former President and CEO of the Company, Eric J. McCracken, a former Chief Financial Officer of the Company, and Michael T. Reed, a former Controller of the Company. The action alleges violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (the **Exchange Act**) and Rule 10b-5 promulgated under that act, including, among other things, that the Company made materially false statements concerning the Company's financial condition and its future prospects. The plaintiff alleges that he suffered damages as the result of his purchase and sale of the Company's Common Stock during the asserted "Class Period" from November 13, 1998 through March 17, 2003. The action seeks compensatory and other damages, and costs and expenses associated with the litigation.

Shortly after the Gaeta Suit was filed, two other putative class actions (the "**Pratsch Suit**" and "**Suarez Suit**") were filed against the same defendants as in the Gaeta Suit and predicated upon alleged violations of the same securities

laws, asserting that plaintiffs purchased the Company's stock at artificially inflated prices during the Class Period and have been damaged thereby. The Pratsch Suit and Suarez Suit assert a Class Period from May 3, 1999 through March 17, 2003. At a February 27, 2004 hearing, plaintiffs in the Suarez Suit voluntarily withdrew their complaint. On February 27, 2004, the Court entered an order consolidating the Gaeta Suit and Pratsch Suit into one case entitled "In re Aerosonic Corporation Securities Litigation," appointing Lead Plaintiffs (the "Miville Group"), approving the selection of Lead Plaintiffs' Counsel (Berger & Montague P.C.) On April 27, 2004, Lead Plaintiffs filed an amended and consolidated class action complaint that alleges violation of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 including, among other things, that the Company made materially false statements concerning the Company's financial condition and its future prospects. The amended complaint also added as a defendant, Andrew Nordstrud, a former employee of the company. On June 28, 2004, the Company responded to the amended complaint by filing a motion to dismiss, and each of the other defendants also moved to dismiss the amended complaint. On August 27, 2004 Lead Plaintiffs filed a memorandum of law as a comprehensive opposition to the motion to dismiss.

The outcome of the consolidated class action lawsuit cannot be adequately determined, and the impact upon the Company cannot be assessed, at this time. Any resolution of such litigation could have a material adverse effect upon the Company's financial position, results of operations, and cash flow.

Note 7 Subsequent Events

Subsequent to April 30, 2004 and as of the date of this report, the seven year equipment loan of approximately \$0.2 million that was included as part of the February 25, 2004 refinancing of the Company's debt obligations with Wachovia (as described in Note 5) had been drawn to purchase equipment for the Company's subsidiary in Earlysville, Virginia.

In June 2003, the Company had a small fire in its machine shop that resulted primarily in smoke damage to its machinery and equipment. The Company's machining processes were disrupted for approximately one month, after which production resumed. During the shutdown, the machine shop was restored to operating capacity. The costs for this restoration were borne by the Company's insurance carrier, except for a deductible of \$2,500. In addition to the restoration costs, the Company received reimbursement for business interruption expenses of approximately \$10,000, \$68,000 and \$139,000 in July 2003, October 2003 and January 2004, respectively. These reimbursements were recorded in the Company's financial statements in the periods when the reimbursements were received. In March 2004, the Company retained the services of a business interruption specialist and then submitted a claim to its insurance carrier in April 2004 for the reimbursement of additional business interruption expenses that were identified as having been incurred as a result of the fire. In May 2004, after further negotiations, the Company and the insurance carrier reached a settlement whereby the Company would be reimbursed a total of approximately \$1,214,000 as a result of the business interruption. The Company received the remaining payment of approximately \$997,000 on May 25, 2004, which will be included in the results of operations for the fiscal quarter ending July 31, 2004.

In June 2004, the Company received a notice from the IRS that disallowed refund claims made by the Company when it filed amended tax returns for the January 31, 1998 and 1999 tax years in December 2003. The Company has revised its April 30, 2004 and January 31, 2004 Balance Sheets that are presented in this Form 10-Q to reflect the impact of this event. As a result, the Company has reduced its Income taxes receivable by approximately \$572,000 and has also reduced its Stockholders' equity by approximately \$572,000. The impact of these changes resulted in a prior period adjustment to the Company's January 31, 2000 balance sheet that flow through the balance sheets in each subsequent year. The Company has amended its Annual Report on Form 10-K for the fiscal year ended January 31, 2004 to incorporate this change. The Company will continue working with its tax advisors to determine if any potential additional deferred tax benefits that result from this change can be realized in a future period.

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

Results of Operations

Revenues for the first quarter decreased approximately \$1,648,000 when compared to the first quarter of fiscal year 2003, as restated. This resulted primarily from core instrument sales decreasing by approximately \$708,000 and revenue from the Joint Strike Fighter (**JSF**) development program decreasing by approximately \$867,000, as compared to the first quarter of fiscal year 2003. These decreases in revenue were due to reduced production throughput in the Company's Clearwater operations as well as reduced progress on the JSF program.

Gross profit for the three months ended April 30, 2004 decreased by approximately 31%, or approximately \$905,000, when compared to the first quarter of fiscal year 2004. Approximately \$549,000 of this change is due to a reduction in volume, while the remaining change of approximately \$355,000 is due to changes in sales mix as well as some reductions in manufacturing efficiency in the Clearwater operations.

Selling, general and administrative expenses for the first quarter decreased approximately \$564,000 when compared to the three months ended April 30, 2003. This decrease is attributable to the reductions in audit fees of approximately \$285,000 and legal fees of approximately \$267,000 as well as the completion of engineering software amortization of approximately \$85,000. These decreases were partially offset by an increase in compensation and benefits expense in sales and marketing due to the personnel additions.

Interest expense decreased approximately \$47,000 for the three months ended April 30, 2004 when compared to the three months ended April 30, 2003. This decrease is partially due to lower interest rates, but is largely due to the receipt of interest payments of approximately \$41,000 in conjunction with the Company's receipt of income tax refunds in April 2004.

Miscellaneous income increased approximately \$118,000 for the three months ended April 30, 2004 when compared to the three months ended April 30, 2003. The Company's sale of its Engine Vibration Monitoring System (**EVMS**) product line inventory in February 2004 resulted in miscellaneous income of approximately \$170,000 while a miscellaneous expense of approximately \$35,000 was recorded to settle a claim that was previously asserted by Mrs. Miriam Frank, widow of the Company's founder, Herbert J. Frank. The Company also recognized an expense of approximately \$33,000 for capitalized loan costs that were written off when the long-term debt for which the expenses were incurred was refinanced with Wachovia in February 2004.

Income tax expense increased approximately \$118,000 for the three months ended April 30, 2004 when compared to the three months ended April 30, 2003. The Company recognized a non-recurring benefit through a reduction in its deferred tax asset valuation allowance in the three months ended April 30, 2003.

Liquidity and Capital Resources

Cash used in operating activities was approximately \$1,478,000 for the three months ended April 30, 2004 an increase of approximately \$2,919,000 when compared to the three months ended April 30, 2003. This decrease is primarily attributable to:

A decrease in net income of approximately \$294,000

A decrease due to accounts payable of approximately \$1,761,000 as the Company paid the remainder of its audit and legal fees related to the financial restatement as reported in the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2003

A decrease due to accrued expenses and other liabilities of approximately \$1,177,000 as the Company decreased its liabilities to suppliers for the JSF contract by approximately \$772,000 and auditors of approximately \$404,000

A decrease due to accounts receivable of approximately \$781,000

A decrease in net income taxes receivable and payable of approximately \$408,000 due to the receipt of refunds from the filing of amended tax returns

An increase in compensation and benefits of approximately \$107,000

An increase due to the recording of additional costs and estimated profits in excess of billings of approximately \$226,000 resulting from a comparative reduction in development project activity

An increase of approximately \$307,000 due to reductions in inventories

Cash used in investing activities decreased approximately \$68,000 due to lower investment in Machinery and Equipment.

Cash provided by financing activities increased approximately \$631,000 as the Company completed the refinancing of its debt obligations.

Future capital requirements depend on numerous factors, including research and development, expansion of product lines, the resolution of the recently filed class action suits and potential related litigation, and other factors. Management believes that cash and cash equivalents, together with the Company's cash flow from operations and current borrowing arrangements will provide for these necessary expenditures. Furthermore, the Company may develop and introduce new or enhanced products, respond to competitive pressures, invest or acquire businesses or technologies or respond to unanticipated requirements or developments, which would require additional resources.

As a consequence of the Company's restatement of results of operations and the pending class action lawsuit, the Company's creditworthiness may be diminished from what existed prior to the restatement. The Company's ability to maintain sufficient liquidity in fiscal year 2005 and beyond is highly dependent upon achieving expected operating results. Failure to successfully achieve these results could have a material adverse effect on the Company's liquidity and operations in fiscal year 2005, and could require implementation of further measures, including deferring planned capital expenditures, reducing discretionary spending, and/or, if necessary, selling assets.

Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations are based upon the accompanying unaudited condensed consolidated financial statements, which have been prepared in accordance with accounting principals generally accepted in the United States. The preparation of those financial statements and this Quarterly Report on Form 10-Q requires us to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure items, including disclosure of contingent assets and liabilities, at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions, and as a result of trends and uncertainties identified above under **RESULTS OF OPERATIONS** and **LIQUIDITY AND CAPITAL RESOURCES** . Further, such differences could be material.

Set forth below is a discussion of the Company's critical accounting policies. The Company considers critical accounting policies to be those (i) that require the Company to make estimates that are highly uncertain at the time the estimate is made, (ii) for which a different estimate which could have been made would have a material impact on the Company's financial statements, (iii) that are the most important and pervasive policies utilized, and (iv) that are the most sensitive to material change from external factors. Additionally, the policies discussed below are critical to an understanding of the financial statements because their application places the most significant demands on management's judgment, with financial reporting results relying on estimates about the effect of matters that are highly uncertain. Specific risks for these critical accounting policies are described in the following paragraphs. The impact and any associated risks related to these policies on business operations is discussed throughout this MD&A where such policies affect reported and expected financial results.

Senior management has discussed the development and selection of the critical accounting estimates and the related disclosure included herein with the Audit Committee of the Board of Directors.

Revenue Recognition

The Company manufactures most of its products on a build-to-order basis and ships products upon completion. The Company has a policy of strict adherence to the provisions of SAB 101 in order to accurately state its revenues in each accounting period. For certain situations, some judgment is required, but most sales have clear revenue recognition criteria.

Revenue sources for product sales are largely from sales to commercial and government customers. The majority of customer sales terms are F.O.B. origin, although some customer terms are F.O.B. destination. For those customers where terms are origin , revenue is generally recognized upon shipment, unless additional prevailing factors would not

be in accordance with the revenue recognition requirements of SAB 101. For those customers whose terms are destination , revenue is generally not recognized until goods arrive at the customers premises and all other revenue recognition criteria are met.

The Company experiences a certain degree of sales returns that varies over time. Generally such returns occur within no more than 90 days after shipment by the Company to its customers. In accordance with SFAS 48 Revenue Recognition When Right of Return Exists, the Company is able to make a reasonable estimation of expected sales returns based upon history and as contemplated by the requirements of SFAS 48. For example, sales returns may occur if delivery schedules are changed by customers after products have shipped or if products are received by customers but do not meet specifications. In such cases, customers may choose to return products to the Company. Absent such circumstances, customers do not have a right to return products if the Company has met all contractual obligations. The Company has established a sales return reserve that approximates an expected level of sales returns over a 90-day period.

From time to time, the Company will jointly develop products with its customers for future applications. In such circumstances, the Company recognizes revenue on a percentage-of-completion basis, measured by the percentage of costs incurred to date to estimated total costs for the contract. This method is used because management considers expended costs to be the best available measure of progress on the contracts. The percentage of completion contract costs include direct labor, material, subcontracting costs, test facilities, and other indirect costs as allocated. Other operating costs are charged to expense as incurred. During fiscal 2003, the Company secured one long-term fixed-price contract for the development of instrumentation for the Joint Strike Fighter program.

Occasionally the Company enters into research and development contracts with customers. The Company accounts for such contracts on the basis of the lesser of non-refundable cash versus percentage of completion.

Accounts Receivable Allowance for Doubtful Accounts and Credit Losses

The Company continuously evaluates its customers and provides reserves for anticipated credit losses as soon as collection becomes compromised. The Company does maintain a limited reserve in anticipation that smaller accounts may become a collection issue, which occurs from time to time based on historical experience. However, most of the Company's customers are financially sound and the Company's history of bad debts is relatively low. While credit losses have historically been within expectations and the provisions established, the Company cannot guarantee that it will continue to experience the same credit loss rates that have been experienced in the past. Measurement of such losses requires consideration of historical loss experience, including the need to adjust for current conditions, and judgments about the probable effects of relevant observable data, including present economic conditions such as delinquency rates and financial health of specific customers.

Provisions for Excess and Obsolete Inventory Losses and Residual Value Losses

The Company values its inventory at the lower of cost (using a method that approximates the first-in, first-out method) or net realizable value. Reviews of inventory quantities on hand have been conducted to determine if usage or sales history supports maintaining inventory values at full cost or if it has instead become necessary to record a provision for slow moving, excess and obsolete inventory based primarily on estimated forecasts of product demand and production requirements for the subsequent twenty four months. Estimates of future product demand may prove to be inaccurate, in which case the Company may understate or overstate the provision required for excess and obsolete inventory. Although the Company endeavors to ensure the accuracy of forecasts of future product demand, any significant unanticipated changes in demand or technological developments could have a significant impact on the value of inventory and consequently reported operating results.

Work In Process Inventories

Management employs certain methods to estimate the value of work in process inventories for financial reporting purposes. Company practice is to conduct cycle counts of inventory at its Clearwater, Florida and Earlysville, Virginia operations throughout the year. Generally, for items that are in process at the end of a fiscal year, management will make an estimate regarding the percentage of completion of such items in order to accurately reflect costs incurred to date on the production of the items that are still in process. These estimates are affected by the nature of the operation at which the items are located at the time a physical inventory is conducted, and are subject to judgment.

Manufacturing Overhead Cost Application

The Company establishes its inventoriable cost of manufacturing overhead by calculating its overhead costs as a percentage of direct labor and applying that percentage to direct labor that has been charged to inventory on a twelve month rolling average basis. This application percentage is reviewed at least quarterly and is adjusted at least annually.

Deferred Tax Asset Valuation Allowance

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards (**SFAS**) No. 109, Accounting for Income Taxes. Under this method, deferred tax liabilities and assets are determined based on the difference between the financial statement carrying amounts and tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse. A valuation allowance is provided against the future benefit of deferred tax assets if it is determined that it is more likely than not that the future tax benefits associated with the deferred tax asset will not be realized.

Long-Lived Assets

Management periodically evaluates long-lived assets for potential impairment and will record an impairment charge whenever events or changes in circumstances indicate the carrying amount of the assets may not be fully recoverable. As of April 30, 2004 and January 31, 2004, management does not believe that any assets are impaired.

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The Company will capitalize production costs for computer software that is to be utilized as an integral part of a product when both; (a) technological feasibility is established for the software and (b) all research and development activities for the other components of the product have been completed. Amortization is charged to expense at the greater of the expected unit sales versus units sold or the straight line method for a period of three years from the date the product becomes available for general release to customers.

Other Accounts Affected by Management Estimates

From time to time, management will utilize estimates when preparing the financial statements of the Company. Such areas include allowances for doubtful accounts, reserves for warranty and sales returns, depreciation, amortization and other accruals.

The Company has established a provision for warranty claims in anticipation of a certain degree of warranty activity, which generally is a minimal expense. This provision is based upon recent warranty experience.

Off-Balance Sheet Arrangements

The Company does not maintain off-balance sheet arrangements nor does it participate in non-exchange traded contracts requiring fair value accounting treatment.

Contractual Obligations

The Company's contractual obligations for future minimum payments under our long-term debt and operating leases as of April 30, 2004 are as follows:

		<u>Payments Due by Period</u>			
		Less than			
Contractual	Total	One Year	1 - 3 years	4 - 5 years	> 5 years
Obligations					

Purchase commitments	\$ 6,703,000	\$ 6,227,000	\$ 458,000	\$ 18,000	\$ -
Long-term debt	3,042,000	259,000	600,000	400,000	1,783,000
Operating leases	1,116,000	398,000	718,000	-	-
Total	\$10,861,000	\$ 6,884,000	\$ 1,776,000	\$ 418,000	\$ 1,783,000

Item 3 Quantitative and Qualitative Disclosures about Market Risk.

The primary market risk exposure for the Company is interest rate risk. The Company does not currently utilize any financial instruments to manage interest rate risk.

Item 4 Controls and Procedures.

As of April 30, 2004, Aerosonic's Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of Aerosonic's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) and concluded that such disclosure controls and procedures were effective as of such date.

PART II OTHER INFORMATION

Item 1 Legal Proceedings.

SEC Formal Investigation and Action Against Former Executives

The Company is the subject of a Formal Order of Investigation issued by the U.S. Securities and Exchange Commission (the "SEC") on May 13, 2003 with respect to potential violations of the federal securities laws in connection with the accounting misstatements and contributing causes disclosed by the Company in press releases dated March 17 and May 22, 2003 and further discussed in the Company's annual report for the fiscal year ended January 31, 2003 and the subsequent quarterly reports on Form 10-Q, which the Company brought to the attention of the SEC in conjunction with management's internal investigation, and other potential issues. The Company received a letter from the SEC dated October 27, 2004 advising the Company that the SEC investigation has been terminated as to the Company and that no enforcement action has been recommended to the Commission, as to the Company.

On October 18, 2004, the SEC filed a Complaint for Injunctive and Other Relief against John Mervyn Nabors, a former chief executive officer of the Company, and Eric J McCracken, a former chief financial officer of the Company, alleging, among other charges, that Mr. Nabors and Mr McCracken implemented various accounting schemes designed to artificially inflate the Company's reported pre-tax earnings, and that they caused the Company to report inflated earnings by recording fictitious and premature revenue. The SEC reported that Mr. Nabors has reached a settlement of this matter with the SEC and that concurrently with its Complaint, the SEC filed Mr. Nabors' Consent to the proposed judgment (without his admitting or denying the allegations of the SEC's Complaint), and the proposed Final Judgment, which permanently enjoins Mr. Nabors from violating antifraud and other provisions of the federal securities laws, bars Mr. Nabors from serving as an officer or director of a public company and orders him to pay disgorgement of \$210,200 and civil money penalties of \$50,000 to a fund for the benefit of defrauded investors, including those who held the Company's shares during the time period alleged in the SEC Complaint. The SEC's case against Mr. McCracken is pending.

Class Action Litigation

On November 12, 2003, a class action lawsuit was filed in the United States District Court for the Middle District of Florida by Sebastian P. Gaeta, individually and on behalf of all other similarly situated (the **Gaeta Suit**), against the Company, PricewaterhouseCoopers LLP, the Company's former independent accountant, J. Mervyn Nabors, a former director and former President and CEO of the Company, Eric J. McCracken, a former Chief Financial Officer of the Company, and Michael T. Reed, a former Controller of the Company. The action alleges violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (the **Exchange Act**) and Rule 10b-5 promulgated under that act, including, among other things, that the Company made materially false statements concerning the Company's financial condition and its future prospects. The plaintiff alleges that he suffered damages as the result of his purchase and sale of the Company's Common Stock during the asserted Class Period from November 13, 1998 through March 17, 2003. The action seeks compensatory and other damages, and costs and expenses associated with the litigation.

Shortly after the Gaeta Suit was filed, two other putative class actions (the "**Pratsch Suit**" and "**Suarez Suit**") were filed against the same defendants as in the Gaeta Suit and predicated upon alleged violations of the same securities laws, asserting that plaintiffs purchased the Company's stock at artificially inflated prices during the Class Period and have been damaged thereby. The Pratsch Suit and Suarez Suit assert a Class Period from May 3, 1999 through March 17, 2003. At a February 27, 2004 hearing, plaintiffs in the Suarez Suit voluntarily withdrew their complaint. On February 27, 2004, the Court entered an order consolidating the Gaeta Suit and Pratsch Suit into one case entitled "In re Aerosonic Corporation Securities Litigation," appointing Lead Plaintiffs (the "Miville Group"), approving the selection of Lead Plaintiffs' Counsel (Berger & Montague P.C.) On April 27, 2004, Lead Plaintiffs filed an amended and consolidated class action complaint that alleges violation of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 including, among other things, that the Company made materially false statements concerning the Company's financial condition and its future prospects. The amended complaint also added as a defendant, Andrew Nordstrud, a former employee of the company. On June 28, 2004, the Company responded to the amended complaint by filing a motion to dismiss, and each of the other defendants also moved to dismiss the amended complaint. On August 27, 2004 Lead Plaintiffs filed a memorandum of law as a comprehensive opposition to the motion to dismiss.

The outcome of the consolidated class action lawsuit cannot be adequately determined, and the impact upon the Company cannot be assessed, at this time. Any resolution of such litigation could have a material adverse effect upon the Company's financial position, results of operations, and cash flow.

Additional Proceedings and Matters

In addition to the foregoing, from time to time, the Company is involved in certain claims and legal actions arising in the ordinary course of business. In the opinion of management, at this time, there are no claims or legal actions that will have a material adverse effect on the Company's financial position, results of operations, or liquidity.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5. OTHER INFORMATION

None

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Item 6 Exhibits and Reports on Form 8-K.

Exhibit No.

Description of Exhibit

3.1

Restated Certificate of Incorporation of Instrument Technology Corporation, filed on January 12, 1970, incorporated by reference to the Company's Annual Report on Form 10-K for the year ended January 31, 2003, filed on October 31, 2003.

3.2

Certificate of Agreement of Merger between Instrument Technology Corporation and Aerosonic Corporation, filed on January 12, 1970, incorporated by reference to the Company's Annual Report on Form 10-K for the year ended January 31, 2003, filed on October 31, 2003.

3.3

Certificate of Amendment to the Articles of Incorporation, changing the name Instrument Technology Corporation to Aerosonic Corporation, filed on September 21, 1970, incorporated by reference to the Company's Annual Report on Form 10-K for the year ended January 31, 2003, filed on October 31, 2003.

3.4

Certificate of Amendment to the Articles of Incorporation of Aerosonic Corporation, filed on August 6, 1971, incorporated by reference to the Company's Annual Report on Form 10-K for the year ended January 31, 2003, filed on October 31, 2003.

3.5

Certificate of Reduction of Capital of Aerosonic Corporation, filed on June 5, 1978, incorporated by reference to the Company's Annual Report on Form 10-K for the year ended January 31, 2003, filed on October 31, 2003.

3.6

Certificate of Amendment to Articles of Incorporation of Aerosonic Corporation, filed on February 12, 1993, incorporated by reference to the Company's Annual Report on Form 10-K for the year ended January 31, 2003, filed on October 31, 2003.

3.7

Composite of Amendments to Articles of Incorporation of Aerosonic Corporation (prepared by the Registrant and not filed with the Secretary of State of the State of Delaware), incorporated by reference to the Company's Annual Report on Form 10-K for the year ended January 31, 2003, filed on October 31, 2003.

3.8

Bylaws of the Company, incorporated by reference to the Company's Annual Report on Form 10-K for the year ended January 31, 2003, filed on October 31, 2003.

10.31

Loan Agreement, dated February 24, 2004, between Aerosonic Corporation and Wachovia Bank N.A., incorporated by reference to the Company's Annual Report on Form 10-K for the year ended January 31, 2004, filed on April 6, 2004

10.32

Promissory Note, dated February 16, 2004, issued by Aerosonic Corporation and Avionics Specialties, Inc. to Wachovia Bank N.A., incorporated by reference to the Company's Annual Report on Form 10-K for the year ended January 31, 2004, filed on April 6, 2004

10.33

Term Promissory Note, dated February 16, 2004, issued by Aerosonic Corporation and Avionics Specialties, Inc. to Wachovia Bank N.A., incorporated by reference to the Company's Annual Report on Form 10-K for the year ended January 31, 2004, filed on April 6, 2004

10.34

Revolving Promissory Note, dated February 16, 2004, issued by Aerosonic Corporation and Avionics Specialties, Inc. to Wachovia Bank N.A., incorporated by reference to the Company's Annual Report on Form 10-K for the year ended January 31, 2004, filed on April 6, 2004

10.35

Mortgage, Assignment of Rents and Security Agreement dated February 24, 2004 between Aerosonic Corporation and Wachovia Bank, N.A., incorporated by reference to the Company's Annual Report on Form 10-K for the year ended January 31, 2004, filed on April 6, 2004.

Item 6 Exhibits and Reports on Form 8-K (continued).

Exhibit No.

Description of Exhibit

10.36

Deed of Trust, Assignment of Rents and Security Agreement dated February 24, 2004 by and among Avionics Specialties, Inc. TRSTE, Inc. and Wachovia Bank, N.A., incorporated by reference to the Company's Annual Report on Form 10-K for the year ended January 31, 2004, filed on April 6, 2004

31.1

Section 302 Certifications

31.2

Section 302 Certifications

32.1

Section 906 Certifications

32.2

Section 906 Certifications

(b) Reports on Form 8-K

During the first quarter of fiscal year 2005, the Company filed no Current Reports on Form 8-K.

TPA:342303:1

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.

Date: December 7, 2004

AEROSONIC CORPORATION

/s/ David A. Baldini

David A. Baldini, President and Chief Executive Officer

Date: December 7, 2004

AEROSONIC CORPORATION

/s/ Gary E. Colbert

Gary E. Colbert, Chief Financial Officer