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AERO SYSTEMS ENGINEERING INC
Form 10-K405
March 13, 2001

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2000

Commission file number 0-7390

AERO SYSTEMS ENGINEERING, INC.

(Exact name of registrant as specified in its charter)

Minnesota

(State of incorporation)

41-0913117

(I.R.S. Employer
Identification No.)

358 East Fillmore Avenue, St. Paul, Minnesota

(Address of principal executive offices)

55107

(Zip Code)

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

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, Par Value \$.20 Per Share

(Title of Class)

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 twelve 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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

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The aggregate market value of the voting stock held by nonaffiliates of the registrant as of January 31, 2001 was approximately \$1,261,035 based upon the average of the closing bid and asked prices of the stock on such date.

The number of common shares outstanding as of January 31, 2001 was 4,401,625.

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DOCUMENTS INCORPORATED BY REFERENCE

The following documents are incorporated by reference into the Form 10-K:

DOCUMENT	PARTS OF FORM 10-K INTO WHICH INCORPORATED BY REFERENCE
Proxy Statement to be filed on or before April 30, 2001 for the annual meeting of shareholders on May 30, 2001	III

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CROSS-REFERENCE SHEET BETWEEN ITEMS IN PART III OF FORM 10-K AND PROXY STATEMENT
PURSUANT TO GENERAL INSTRUCTION G(4)

DOCUMENT	SUBJECT HEADINGS IN PROXY STATEMENT
Item 10. Directors and Executive Officers of the Registrant	Election of Director
Item 11. Executive Compensation	Election of Director
Item 12. Security Ownership of Certain Beneficial Owners and Management	Principal Shareholder
Item 13. Certain Relationships and Related Transactions	Election of Director

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PART I

ITEM 1 - BUSINESS

General Development of Business - Aero Systems Engineering, Inc. ("ASE" or the "Company") is a global turnkey provider of test facilities and systems for the aerodynamic and propulsion test system markets. ASE is a Minnesota corporation that was organized on May 11, 1967. From that time until 1993, the Company had been primarily engaged in selling products and services related to testing

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turbine engines. On July 30, 1993, the Company purchased substantially all of the assets of FluidDyne Engineering Corporation ("FluidDyne"), relating to FluidDyne's business of designing, constructing and supplying various types of test facilities, such as wind tunnels and other aerodynamic test facilities. The acquisition also included the Aerotest Laboratory, which provides aeropropulsion component and aerodynamic testing services.

Approximately 80% of the Company's outstanding common stock is owned by Celsius Inc. Celsius Inc. is a wholly-owned subsidiary of Celsius AB, which is a Swedish company. Celsius AB was acquired by SAAB AB in March 2000.

The plan of operations for 2001 with respect to the Company is to continue with its current activities and operations in the test cell, wind tunnel and aerodynamic testing markets. In addition, the Company plans to explore new markets as deemed appropriate through acquisitions or using joint ventures with established companies. Currently, the Company has no agreements regarding such opportunities. The Company is attempting to expand into the industrial engine and small commuter engine testing market place. Also, acoustic measurement processes to measure noise levels are technologies where the Company is creating new customers and providing additional value to existing customers.

Lines of Business/Segment Reporting - The Company is engaged in two lines of business. The first is related to the design, equipping, manufacture and construction of test facilities for turbine engines, engine accessories and wind tunnels. The second business line is providing aeropropulsion component testing and aerodynamic testing services at the Aerotest Laboratory facility. The Company regards these lines of business as being in their entirety one segment of business.

Products and Services - The Company's products and services include the following:

- o Design and overall project management for construction of jet engine testing facilities and wind tunnel testing facilities;
- o Design and manufacture of electronic and mechanical turbine engine testing equipment;
- o Providing of aerodynamic and propulsion system testing services;
- o Application of engineering technology to specific engine and aerodynamic testing problems;
- o Providing acoustic design and measurement services.

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The Company undertakes research and development projects by applying leading edge technology to customer situations in engine, wind tunnel and aerodynamic testing.

The Company's principal sources of revenue are the design and construction of turbine and wind tunnel test facilities and associated test equipment. An additional important source of revenue for the Company is providing aerodynamic and propulsion system testing services at the Aerotest Laboratory.

The Company does not generally produce products as inventory items; rather, the Company's products are usually made to order and are limited to individual application and adaptation. The Company does build and inventory limited amounts

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of selected electronic products and spare parts and components for customer support.

Most of the instrumentation and much of the equipment used in a jet engine or wind tunnel test facility are not manufactured by the Company. The Company adds value by combining these electronic and mechanical components purchased from other companies and assembles them to make the desired testing equipment or facility. For a complete test facility, which includes design and construction of a building, the Company subcontracts certain civil aspects of the project.

Sales of test facilities have resulted principally from direct customer contacts, independent sales agents and the Company's internal marketing staff.

Raw Materials - The principal raw materials used by the Company are raw and fabricated steel and aluminum. Various electronic components are also purchased and assembled into completed units. These materials are readily available from a number of suppliers. Therefore, the Company anticipates no difficulty in securing an alternate source of supply of these products should it be unable to obtain materials from its present suppliers.

Patents and Trademarks - The Company currently owns several patents relating to a free piston shock tube and for a test cell stack design. The Company has applied to various foreign countries' patent offices to register the U.S. patents in those countries.

Periodically, the Company seeks trademark protection for certain of its products. The Company does not hold nor has it issued any significant licenses, franchises or concessions. While the Company may apply for patents on some of its instruments or components thereof, generally, the Company does not consider the patentability or the protection that may be afforded by patents to be material to its present business.

Seasonal Nature of Business - The business of the Company is not seasonal in nature.

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Working Capital - The Company is not required to maintain significant amounts of inventory or supplies. The Company does not generally grant extended payment terms to customers. However, because many of the Company's contracts with its customers are over multiple years, outstanding balances due from a customer may be quite large. The Company generally is required to issue standby letters of credit as a guarantee for customers' advances and performance of the project by the Company.

Additionally, in various governmental contracts, there are retainages, usually 5% - 10%, that are held back by governmental agencies to ensure contract performance. The Company's practices concerning inventory and credit are consistent with practices in the industry.

Availability of working capital financing is necessary for the current operations of the business. The Company currently has a line of credit with a branch of a Swedish bank in New York for \$6,000,000. Funds provided by this bank are actually provided by Celsius Inc. and ultimately by SAAB treasury. In consideration of providing working capital funds, a first security interest in all assets of the Company has been granted to Celsius Inc. and a fee is also paid to Celsius Inc. Although the Company's management has no reason to believe that availability of such funds from Celsius Inc. will cease in the near future,

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there can be no assurance that such availability will continue indefinitely.

Customers - The Company provides products and services for numerous companies in the aircraft industry as well as the U.S. federal government and foreign governmental entities. The orders to provide these services can originate from many customers and quite frequently result in repeat business. In 2000, three customers each accounted for more than 10% of the Company's revenues. These three customers were Boeing, General Electric and DSO-Singapore. The Company believes that the loss of no other single customer would have a material adverse effect on its future revenues.

Backlog - The Company's order backlog constitutes future revenue to be earned on contracts, including unearned revenue on projects currently in progress. The backlog of orders as of December 31, 2000 was \$27,710,000. This compares with a backlog of \$18,759,000 on December 31, 1999.

Competition - There are several other firms in the world offering services similar to those provided by the Company. These firms are based in North America, Europe and the Pacific Rim. The exact competitive position of the Company in the markets in which it operates is not known to the Company, but the Company believes that it is one of the major suppliers in the markets it serves. The technology used by the Company is not proprietary, and most commercial airlines, engine manufacturers and airframe manufacturers have the in-house engineering capability to compete directly with the Company in the design and building of jet engine test facilities. The Company believes that in order to reduce cost and risk, many of these firms generally prefer to engage the

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services of the Company or one of its competitors. In the test cell industry in which the Company competes, the principal means of competition are price, technological design, project management knowledge and delivery capability.

In the wind tunnel facilities area, the Company has historically designed and built high-speed wind tunnels for worldwide governmental agencies, commercial companies and other research institutions.

With worldwide defense budgets being reduced during the past few years, the number of wind tunnel projects has been steadily declining. However, there has been growth in the automotive wind tunnel area. In order to capture some of this new automotive wind tunnel business, ASE had previously entered into a teaming agreement with a leading automotive architecture and engineering company, and recently established a marketing agreement with an agent in the Detroit area. The team continues to pursue new opportunities but to date no contracts have been awarded. Also, the activities involving commercial aviation wind tunnels applications have been growing, and continue to provide opportunities for new business.

The Company has in the past been aided in financing projects by utilizing the financial strength of SAAB AB. Without the ability to issue standby letters of credit to guarantee the performance of the project, ASE might not have been the prime contractor on certain of these projects.

Research and Development - Research and development performed by the Company is applied engineering, that is, applying present engineering knowledge and technology toward solving customer problems in turbine engine and aerodynamic testing. The Company is currently enhancing the ASE2000, which is its latest computer data acquisition system. The expense of research and development was

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\$625,000, \$743,000 and \$521,000 for the years ended December 31, 2000, 1999 and 1998, respectively.

Environmental Matters - There has not been, and it is not expected that there will be, any material effect upon capital expenditures, earnings or the competitive position of the Company due to compliance with federal, state and local environmental protection regulations.

Employees - As of December 31, 2000, the Company employed 173 employees. Contract labor has been used as business conditions require.

Foreign Operations - While business in foreign countries is always subject to interference or restrictions by foreign governments or restrictions imposed by the United States government, the Company believes that the nature of its business is such that it is not likely to be subject to such interference. Wind tunnels with a Mach number in excess of .9 need to have approval from the U.S. State Department if they are sold to a foreign country.

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For certain foreign and domestic projects, the Company obtains payment terms or financial protections, such as irrevocable letters of credit and bank guarantees, to better assure payment to the Company in the event of any financial difficulty. Nevertheless, foreign projects always have inherent foreign currency risks with respect to currency exposures or purchase commitments. The Company hedges currency exposure as deemed appropriate to minimize the foreign exchange exposure.

ITEM 2 - PROPERTIES

The Company's headquarters are located in a concrete building in a light industrial area at 358 East Fillmore Avenue, Saint Paul, Minnesota that it has been occupying since 1971. The Company purchased this facility during 1993 from the Port Authority of Saint Paul (the "Port Authority"). Currently, the Company has approximately 52,000 total square feet, of which 45,000 square feet is used for engineering and administrative offices and 7,000 square feet is used for manufacturing.

The Company leases from the Port Authority a building that has 24,000 square feet of manufacturing and warehouse space located at 181 East Florida Street, Saint Paul, Minnesota. The lease agreement contains several purchase options at various times during the lease period. The most favorable option occurs at the end of the lease period in July 2002, when the Company may purchase the facility for approximately \$95,000.

The Company owns an aerodynamic testing facility located at 13825 Schmidt Lake Road, Plymouth, Minnesota. Currently, the Company has approximately 25,000 total square feet of specialized engineering and testing space at this facility, of which 18,000 square feet is used for manufacturing and 7,000 square feet is used for offices.

The Company leases 6,500 square feet of office space in Hampton, Virginia. This office space is occupied by employees working on current contracts with NASA. The lease is in effect until April 2004.

ITEM 3 - LEGAL PROCEEDINGS

There are no significant legal proceedings in process at the time of this

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report.

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

No matter was submitted during the fourth quarter of 2000 to a vote of security holders through the solicitation of proxies or otherwise.

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PART II

ITEM 5 - MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's common stock currently is quoted on The Nasdaq SmallCap MarketSM. On January 31, 2001, the closing sale price for the Company's common stock was \$1.63.

The high and low sales prices for the Company's common stock for each quarter during 1999 and 2000, as quoted on Nasdaq, were as follows:

	HIGH	LOW
	----	---
1999:		
First Quarter	\$1.75	\$1.14
Second Quarter	2.13	1.13
Third Quarter	1.63	.75
Fourth Quarter	2.50	1.00
2000:		
First Quarter	\$3.13	\$1.44
Second Quarter	2.66	1.75
Third Quarter	2.25	1.25
Fourth Quarter	2.06	1.28

The quotations set forth above reflect inter-dealer prices, without retail markup, markdown or commission, and may not necessarily represent actual transactions.

No cash dividends have ever been paid in the history of the Company. The Company intends to use its earnings to finance operations and does not intend to pay cash dividends on its capital stock in the foreseeable future. On March 31, 1999, the Company issued a 15% stock dividend to shareholders of record as of March 10, 1999. Financial information contained in this report has been adjusted to reflect the impact of the 15% stock dividend. As of December 31, 2000, there were approximately 191 holders of record of common stock of the Company and 4,401,625 total shares outstanding.

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ITEM 6 - SELECTED FINANCIAL DATA

Selected financial data for the years ended December 31 are as follows:

	2000 ----	1999 ----	1998 ----	1997 ----	
SELECTED INCOME STATEMENT DATA					
Earned revenue	\$30,646,114	\$31,061,082	\$27,181,448	\$25,032,452	\$20,000,000
Net income (loss)	331,003	(645,307)	665,200	(400,733)	(2,000,000)
Net income (loss) per common share	.08	(.15)	.15	(.09)	
Weighted average common shares outstanding	4,401,625	4,401,625	4,401,625	4,401,625	4,401,625
SELECTED BALANCE SHEET DATA					
Current assets	\$14,026,405	\$15,055,233	\$16,004,487	\$14,936,589	\$11,000,000
Current liabilities	13,919,641	15,620,895	15,850,389	15,107,440	10,000,000
Working capital	106,764	(565,662)	154,098	(170,851)	1,000,000
Total assets	19,210,113	20,683,801	21,480,070	20,574,712	17,000,000
Long-term debt and capital lease obligations	119,726	170,583	234,119	732,865	1,000,000
Stockholders' equity	4,600,804	4,269,801	4,915,108	4,249,908	4,000,000

ITEM 7 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Aero Systems Engineering, Inc. is engaged in selling products and services related to (1) testing turbine engines and design and operation of aerodynamic wind tunnels, and (2) providing aerodynamic and propulsion system testing services. The Company designs the testing facility but subcontracts the civil engineering work and construction to local civil construction companies.

Results of Operations - The backlog of orders as of December 31, 2000 was \$27,710,000, which consisted of \$26,221,000 that was related to jet engine test cell projects and wind tunnel projects and \$1,489,000 related to Aerotest Lab/Other. Backlog of orders as of December 31, 1999 was \$18,759,000, of which \$18,297,000 was related to test cell and wind tunnel projects and \$462,000 related to Aerotest Lab/Other.

The change in backlog from 1999 to 2000 represents a 48% increase in total backlog. Also, new orders received in 2000 totaled \$39,598,000 as compared to the previous year of \$23,302,000. The 2000 increase in backlog was mostly related to the receipt of one large wind tunnel order for \$23.3 million to supply a wind tunnel in Singapore.

Earned revenue for the year ended December 31, 2000 was \$30,646,000, a decrease of \$415,000 or 1% as compared to 1999 revenue of \$31,061,000. Earned revenue for 1998 was \$27,181,000. The revenue decrease from 1999 to 2000 was mostly due to the fact

that 1999 revenue included approximately \$1.9 million of Year 2000 upgrade

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projects of which very little continued into 2000. This was partially offset by revenue growth in test cells and the Aerotest Lab.

The cost of earned revenue, which includes manufacturing and engineering costs, was 78% of earned revenue in 2000 as compared to 82% in 1999 and 78% in 1998. The percentage decrease in cost of earned revenue during 2000 was mostly due to the fact that 1999 included additional costs on two major wind tunnel projects and additional reserves recorded for the settlement of a long outstanding dispute with a foreign contractor. There were no similar major cost increases that occurred in 2000.

Operating expenses were \$5,316,000, \$4,591,000 and \$3,916,000 in years 2000, 1999 and 1998, respectively. These expenses increased 16% in 2000 as compared to 1999 primarily as a result of investments in marketing personnel and bid and proposal activities.

Research and Development (R&D) costs were \$625,000, \$743,000 and \$521,000 in years 2000, 1999 and 1998, respectively, and were primarily related to activities to enhance the capabilities of the ASE2000 Computer Data Acquisition System. This activity will continue into 2001, which management believes will further improve the marketability of the system.

Interest expense was \$574,000, \$719,000 and \$888,000 in years 2000, 1999 and 1998, respectively. The major item bearing interest expense is the line of credit. The average outstanding borrowings were \$4,736,000 and \$5,838,000 during 2000 and 1999, respectively. The decrease in borrowings from 1999 to 2000 reflects improved payment terms on new contracts. The weighted average interest rate for 2000 was 10.6% on the line of credit.

The Company recorded income tax expense of \$6,000 in 2000, as compared to \$10,000 in 1999 and \$0 in 1998.

The Company recorded net income of \$331,000 in 2000, a net loss of \$645,000 in 1999, and net income of \$665,000 in 1998. The improvement from 1999 was due to the fact that 1999 included major cost overruns on a couple of wind tunnel projects and the recording of additional reserves for the settlement of a long outstanding dispute. Similar events did not occur in 2000.

Liquidity and Capital Resources - To minimize working capital requirements, the Company attempts to match contract payments with related contract expenditures. The Company's current ratio was 1.0 as of December 31, 2000, 1999 and 1998. Working capital amounts were \$107,000 as of December 31, 2000, \$(566,000) as of December 31, 1999 and \$154,000 as of December 31, 1998.

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The December 31, 2000 accounts receivable balance was \$6,361,000, a decrease of \$1,944,000, as compared to 1999's balance of \$8,305,000. The decrease in the accounts receivable balance for 2000 was due to the contractual timing of customer billings.

Accounts payable and accrued expenses amounts were \$4,832,000 and \$6,656,000 in 2000 and 1999, respectively. The 2000 decrease is \$1,824,000 or 27%, as compared to 1999. The decrease from 1999 is due primarily to the timing of procurement activities for the existing projects, of which much had been completed prior to the end of the year.

Billings in excess of earnings were \$2,061,000, a decrease of \$3,177,000 when

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compared to 1999's balance of \$5,238,000. This decrease is due primarily 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 had fully utilized its available line of credit as of December 31, 2000. The total line of credit available is \$6,000,000 at a branch of a Swedish bank in New York City, which is guaranteed by the Company's immediate parent, Celsius Inc. The balance of the line of credit at December 31, 2000 was \$6,976,000. The increase in the line of credit at December 31, 2000 reflects the timing of contract invoicing in relation to project expenditures. Although the line of credit has a \$6,000,000 limit, Celsius Inc. has allowed the Company to exceed this limit for short periods of time. The portion over \$6,000,000 is assessed a higher interest rate.

Current financial resources, i.e., working capital and short-term line of credit facilities, plus anticipated funds from operations are expected to be adequate to meet cash requirements in 2001.

Capital expenditures were \$655,000, \$1,078,000 and \$735,000 in years 2000, 1999 and 1998, respectively. The 2000 decrease was 39%, as compared to 1999. Most of the 2000 capital expenditures were used to update desktop and network equipment and facility improvements. The 1999 capital expenditures included similar activities and the acquisition and installation of a new business computer system.

Highly competitive market conditions have minimized the effect of inflation on contract selling prices and the cost of purchased materials.

During 2000, approximately 46% of revenues were from international projects. Substantially all of the contract amounts are payable in U.S. dollars. For those contracts that are denominated in foreign currencies, the Company has entered into forward exchange contracts with banks to minimize the foreign currency exchange rate risks.

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ITEM 7A - QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The Company's long-term contracts are substantially all denominated in U.S. dollars. The Company has hedged any exposure to foreign currency fluctuations. A 10% adverse change in foreign currency rates would not have a material effect on the Company's results of operations or financial position.

The Company is also subject to interest rate risk. The Company has not hedged its exposure to interest rate fluctuations; however, a 10% increase or decrease in interest rates would not have a material effect on the Company's results of operations, fair values or cash flows.

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ITEM 8 - FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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Report of Independent Auditors

Stockholders and Board of Directors
Aero Systems Engineering, Inc.

We have audited the accompanying balance sheets of Aero Systems Engineering, Inc. as of December 31, 2000 and 1999, and the related statements of operations, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Aero Systems Engineering, Inc. at December 31, 2000 and 1999, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States.

/s/ Ernst & Young LLP

Minneapolis, Minnesota
January 13, 2001

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Aero Systems Engineering, Inc.

Balance Sheets

	DECEMBER 31	
	2000	1999
	-----	-----
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 47,808	\$ 8,000
Accounts receivable--billed contracts, net of allowances of \$50,000 in 2000 and 1999, including retainages of \$106,000 in 2000 and 1999	6,361,427	8,000
Costs and estimated earnings in excess of billings on uncompleted contracts	5,409,756	4,000
Inventories	1,483,738	1,000
Prepaid expenses	57,899	0
Deferred and prepaid income taxes	665,777	0
	-----	-----
Total current assets	14,026,405	15,000
Property, plant and equipment--net	5,183,708	5,000
	-----	-----
Total assets	\$19,210,113	\$20,000
	=====	=====

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Aero Systems Engineering, Inc.

Balance Sheets (continued)

	DECEMBER 31	
	2000	1999
	-----	-----
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current maturities of capital lease obligations	\$ 50,858	\$ 3,000
Notes payable	6,975,755	3,000
Accounts payable:		
Trade	1,635,791	0
Affiliated companies	--	0
Billings in excess of costs and estimated earnings on uncompleted contracts	2,060,706	5,000

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Accrued warranty and losses	774,417	
Accrued salaries and wages	897,885	
Accrued job costs	444,395	3,
Other accrued liabilities	1,079,834	
	-----	-----
Total current liabilities	13,919,641	15,
Deferred income taxes	569,942	
Capital lease obligations, less current maturities	119,726	
Stockholders' equity:		
Common Stock, \$.20 par value:		
Authorized shares - 10,000,000		
Issued and outstanding shares - 4,401,625	880,325	
Additional paid-in capital	900,292	
Retained earnings	2,820,187	2,
	-----	-----
Total stockholders' equity	4,600,804	4,
	-----	-----
Total liabilities and stockholders' equity	\$19,210,113	\$20,
	=====	=====

See accompanying notes.

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Aero Systems Engineering, Inc.f

Statements of Operations

	YEAR ENDED DECEMBER 31		
	2000	1999	
	-----	-----	-----
Earned revenue	\$30,646,114	\$31,061,082	\$27,
Cost of earned revenue	23,799,532	25,588,018	21,
	-----	-----	-----
Gross profit	6,846,582	5,473,064	6,
Selling, general and administrative expenses	5,315,851	4,590,710	3,
Research and development	625,466	742,559	
	-----	-----	-----
Operating profit	905,265	139,795	1,
Other income (expense):			
Interest income	3,236	2,272	
Interest expense	(574,053)	(718,573)	(
Other	2,815	(58,801)	
	-----	-----	-----
	(568,002)	(775,102)	(
	-----	-----	-----
Income (loss) before income taxes	337,263	(635,307)	

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Income tax expense	(6,260)	(10,000)	
	-----	-----	-----
Net income (loss)	\$ 331,003	\$ (645,307)	\$
	=====	=====	=====
Net income (loss) per common share	\$.08	\$ (.15)	\$
	=====	=====	=====
Weighted average common shares outstanding	4,401,625	4,401,625	4,
	=====	=====	=====

See accompanying notes.

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Aero Systems Engineering, Inc.

Statements of Changes in Stockholders' Equity

	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	RE EA
	SHARES	AMOUNT		
	-----	-----	-----	-----
Balance at January 1, 1998	2,551,717	\$510,343	\$516,722	\$3,
Three-for-two stock split	1,275,856	255,172	(255,172)	
15% stock dividend	574,052	114,810	638,742	(
Net income	--	--	--	
	-----	-----	-----	-----
Balance at December 31, 1998	4,401,625	880,325	900,292	3,
Net loss	--	--	--	(
	-----	-----	-----	-----
Balance at December 31, 1999	4,401,625	880,325	900,292	2,
Net income	--	--	--	
	-----	-----	-----	-----
Balance at December 31, 2000	4,401,625	\$880,325	\$900,292	\$2,
	=====	=====	=====	=====

See accompanying notes.

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Aero Systems Engineering, Inc.

Statements of Cash Flows

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	YEAR ENDED DECEMBER	
	2000	1999
	-----	-----
OPERATING ACTIVITIES		
Net income (loss)	\$ 331,003	\$ (645,307)
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:		
Depreciation and amortization	1,100,086	925,411
Decrease (increase) in assets:		
Accounts receivable	1,943,358	(1,064,110)
Costs and estimated earnings in excess of billings on uncompleted contracts	(641,533)	1,942,454
Inventories	(392,675)	314,991
Prepaid expenses	58,170	(65,218)
(Decrease) increase in liabilities:		
Accounts payable and accrued expenses	(1,824,007)	(579,781)
Income taxes payable	8,260	(5,000)
Billings in excess of costs and estimated earnings on uncompleted contracts	(3,177,718)	3,822,599
Net cash (used in) provided by operating activities	(2,595,056)	4,646,039
INVESTING ACTIVITIES		
Capital expenditures	(655,226)	(1,078,396)
Net cash used in investing activities	(655,226)	(1,078,396)
FINANCING ACTIVITIES		
Net borrowings under line of credit agreements	3,328,800	(3,052,041)
Principal payments on borrowings from affiliates	--	(400,000)
Principal payments under capital lease obligations	(79,186)	(83,217)
Net cash provided by (used in) financing activities	3,249,614	(3,535,258)
Net (decrease) increase in cash and cash equivalents	(668)	32,385
Cash and cash equivalents at beginning of year	48,476	16,091
Cash and cash equivalents at end of year	\$ 47,808	\$ 48,476
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the year for:		
Interest	\$ 574,053	\$ 718,573
Income taxes	260	15,000

See accompanying notes.

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Notes to Financial Statements

December 31, 2000

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

DESCRIPTION OF BUSINESS

The Company's major operations are in the design and manufacture of electronic, mechanical and computerized engine and engine accessory test equipment and the design, equipping and construction of engine test facilities, wind tunnels and other aerodynamic test facilities. In addition, the Company provides aeropropulsion component testing and vehicle aerodynamic testing services. The Company is an 80% owned subsidiary of Celsius Inc. See Note 10.

CASH AND CASH EQUIVALENTS

For purposes of the statements of cash flows, the Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

USE OF ESTIMATES

The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

CONTRACTS

Income on long-term contracts is recognized using the percentage-of-completion method. On contracts where the percentage-of-completion method is used, revenue is recognized for a portion of the total contract revenue, in the proportion that costs incurred bear to management's estimate of total contract costs to be incurred, commencing when progress reaches a point where experience is sufficient to estimate final results with reasonable accuracy. Earnings and costs on contracts are subject to revision throughout the terms of the contract, and any required revisions are made in the periods in which revisions become known. Provision is made for the full amount of anticipated losses in the period in which they are determinable.

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Aero Systems Engineering, Inc.

Notes to Financial Statements (continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Costs and estimated earnings in excess of billings on uncompleted contracts represent revenues recognized on contracts for which billings will be presented in accordance with contract provisions. Such revenues are generally expected to be billed and collected within one year.

INVENTORIES

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Inventories are stated at the lower of cost (determined by the first-in, first-out method) or market.

EARNINGS PER SHARE

Net income (loss) per share of common stock is computed by dividing net income (loss) for the year by the weighted average number of common shares outstanding during the year. The Company has a simple capital structure with only common stock outstanding; therefore, basic and diluted earnings per share are the same.

On March 31, 1999, the Company issued a 15% stock dividend to shareholders of record as of March 10, 1999. Financial information contained in this report has been adjusted to reflect the impact of the 15% stock dividend.

WARRANTY POLICY

The Company's warranty policy generally provides for one-year coverage on defective equipment due to faulty design, workmanship or nonconformity to specifications. Estimated warranty costs are recorded when revenues are recognized.

LONG-LIVED ASSETS

Impairment losses are recorded on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amount.

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Aero Systems Engineering, Inc.

Notes to Financial Statements (continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

DEPRECIATION

Property, plant and equipment are recorded at cost and depreciated over their estimated useful lives of three to forty years using straight-line and accelerated methods. Depreciation expense includes the amortization of capital lease assets.

FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used in estimating the indicated fair values of financial instruments:

Cash and cash equivalents: The carrying amount approximates fair value because of the short maturity of those instruments.

Short-term and long-term debt: The fair value is estimated based on current rates offered for similar debt, which approximates carrying value.

Foreign currency contracts: The fair values of foreign currency contracts (used for hedging purposes) are estimated by obtaining quotes from banks. At December 31, 2000 and 1999, there were no carrying amounts related to foreign

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currency contracts in the balance sheets. The unrealized gains (losses) related to such contracts were not material to the financial statements.

INCOME TAXES

The Company accounts for income taxes under the liability method. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Effective November 1, 1990, the Company became a consolidated subsidiary of Celsius Inc. and is included in the consolidated federal income tax return with Celsius Inc. The Company's income tax provision is calculated and presented on a separate return basis.

Aero Systems Engineering, Inc.

Notes to Financial Statements (continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

DERIVATIVES AND HEDGING

In June 1998, the Financial Accounting Standards Board issued Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, which is required to be adopted in years beginning after June 15, 2000. The Statement will require the Company to recognize all derivatives on the balance sheet at fair value. Changes in the fair value of derivatives that are hedges will either be offset against the change in fair value of the hedged assets, liabilities or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The Company does not anticipate that the adoption of the new Statement will have a significant effect on earnings or financial position of the Company.

2. CONTRACTS IN PROCESS

	YEAR ENDED DECEMBER	
	2000	1999
	-----	-----
Costs incurred on uncompleted contracts	\$40,780,632	\$35,634,000
Estimated earnings thereon	11,780,634	6,365,000
	-----	-----
Total billable on uncompleted contracts	52,561,266	42,000,000
Less billings applicable thereto	49,212,216	42,000,000
	-----	-----
	\$ 3,349,050	\$ ()
	=====	=====
Included in the accompanying balance sheet under the following captions:		
Costs and estimated earnings in excess of billings on uncompleted contracts	\$ 5,409,756	\$ 4,635,000
Billings in excess of costs and estimated earnings on uncompleted contracts	2,060,706	5,365,000

 \$ 3,349,050
 =====

 \$ ()
 =====

Aero Systems Engineering, Inc.

Notes to Financial Statements (continued)

2. CONTRACTS IN PROCESS (CONTINUED)

The Company is a contractor/subcontractor on various U.S. federal government-related firm fixed-price contracts. The negotiated firm, fixed price is subject to downward readjustment if it is subsequently determined that the cost data submitted by the Company is erroneous.

CONCENTRATIONS OF CREDIT RISK

At December 31, 2000, the Company had certain concentrations of credit risk with approximately \$4,673,000 of unbilled charges and approximately \$3,799,000 of accounts receivable from four customers, which are partially secured by letters of credit.

3. INVENTORIES

Inventories consist of the following:

	YEAR ENDED DECEMBER	
	2000	1
	-----	-----
Materials and supplies	\$ 1,103,439	\$
Projects-in-process	380,299	
	-----	-----
	\$ 1,483,738	\$ 1,
	=====	=====

4. PROPERTY, PLANT AND EQUIPMENT

	YEAR ENDED DECEMBER	
	2000	1
	-----	-----
Land	\$ 486,105	\$
Buildings	3,025,460	3,
Furniture, fixtures and equipment	8,325,135	7,
Wind tunnels and instrumentation	2,978,141	2,
Building improvements	1,488,527	1,

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	-----	-----
	16,303,368	15,
Less accumulated depreciation	(11,119,660)	(10,
	-----	-----
Property, plant and equipment--net	\$ 5,183,708	\$ 5,
	=====	=====

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Aero Systems Engineering, Inc.

Notes to Financial Statements (continued)

5. NOTES PAYABLE TO BANKS

At December 31, 2000, the Company had borrowings of \$6,975,755 on a \$6,000,000 line of credit with a bank bearing interest at a variable rate (10.5% at December 31, 2000). As of December 31, 2000, the Company had fully utilized the available borrowings on this line of credit. Although the line of credit has a \$6,000,000 limit, Celsius Inc. has allowed the Company to exceed this limit for short periods of time. The portion over \$6,000,000 is assessed a higher interest rate. At December 31, 1999, the Company had borrowings of \$3,646,955 outstanding on this \$6,000,000 line of credit.

Funds provided under this credit line are actually provided by Celsius Inc. and ultimately from SAAB treasury. A first security interest in all assets of the Company has been granted to Celsius AB, and a fee is paid through Celsius Inc.

During 2000 and 1999, the average borrowings on these lines of credit were \$4,736,000 and \$5,838,000, respectively, with weighted average interest rates during the year of 10.6% and 9.2%, respectively.

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Aero Systems Engineering, Inc.

Notes to Financial Statements (continued)

6. INCOME TAXES

Significant components of the Company's deferred tax liabilities and assets are as follows:

Deferred tax assets:

	DECEMBER 31

	2000

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Contract-related costs	\$ 454,000	\$
Warranty costs	148,000	
Vacation accrual	171,000	
Inventory and receivable reserves	267,000	
Net operating loss carryforward	1,230,000	1,
Other	24,000	
Tax credit carryforwards	103,000	
	-----	-----
Total deferred tax assets	2,397,000	2,
Valuation allowance for deferred tax assets	(1,827,000)	(1,
	-----	-----
Net deferred tax assets	570,000	
Deferred tax liabilities:		
Tax over book depreciation	570,000	
	-----	-----
Net deferred taxes	\$ --	\$
	=====	=====

The net operating loss carryforward of approximately \$3,325,000 will expire beginning in the year 2010. The components of income tax expense (benefit) for the years ended December 31 are:

	2000	1999	
	-----	-----	-----
Current	\$18,000	\$10,000	\$1
Deferred	(12,000)	--	(1
	-----	-----	-----
	\$ 6,000	\$10,000	\$
	=====	=====	=====

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Aero Systems Engineering, Inc.

Notes to Financial Statements (continued)

6. INCOME TAXES (CONTINUED)

Total income tax expense differs from taxes computed by applying the United States statutory federal income tax rate as follows:

	YEAR ENDED DECEMBER 31		
	2000	1999	
	-----	-----	-----
Income taxes at 34%	\$ 115,000	\$ (216,000)	\$ 2
State taxes, net of federal benefit	4,000	3,000	

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Effect of net operating loss carryforward and valuation allowance	(118,000)	211,000	(2
Other	5,000	12,000	
	-----	-----	
	\$ 6,000	\$ 10,000	\$
	=====	=====	=====

7. LEASE OBLIGATIONS

The Company has capitalized leases for facilities and equipment which expire through 2002. The capitalized cost at December 31, 2000 and 1999 was \$857,844 less accumulated amortization of \$562,680 and \$481,638, respectively. One capitalized lease agreement, which relates to a warehouse facility in St. Paul, Minnesota, contains several purchase options at various times during the lease period. The most favorable option occurs at the end of the lease period on July 2002 when the Company may purchase the facility for approximately \$95,000.

The Company also has a number of operating lease agreements primarily involving manufacturing and warehouse space and office equipment, which expire on various dates through 2005. Total rental expense under operating leases for occupancy and equipment was approximately \$217,000, \$213,000 and \$184,000 for 2000, 1999 and 1998, respectively.

Aero Systems Engineering, Inc.

Notes to Financial Statements (continued)

7. LEASE OBLIGATIONS (CONTINUED)

Following is a schedule of future minimum lease payments:

	CAPITAL LEASES	OPERATING LEASES
	-----	-----
Year ending December 31:		
2001	\$ 64,364	\$ 1
2002	126,595	1
2003	--	1
2004	--	
2005		
	-----	-----
Total minimum lease payments	190,959	\$4
		==
Less amount representing interest	20,375	

Present value	170,584	
Less principal amount due currently	50,858	

	\$119,726	
	=====	

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Included in the \$126,595 capital lease payment in 2002 is the \$95,000 purchase option payment to the Port Authority of Saint Paul for the 181 East Florida Street facility.

8. CONTINGENCIES AND COMMITMENTS

Guarantees of approximately \$4,879,316 were outstanding at December 31, 2000 to various customers as bid bonds or in exchange for down payments or warranty performance bonds.

9. RETIREMENT/SAVINGS PLAN

The Company has a Retirement/Savings Plan which qualifies under Section 401(k) of the Internal Revenue Code and covers all employees. Members of the Plan who have completed at least 12 consecutive months of service, during which they have worked at least 1,000 hours, are eligible for the employer matching contribution. Contributions up to 6% of the employees' compensation are matched at a rate of 50% by the Company. Company contributions to the plan for the years ended December 31, 2000, 1999 and 1998 were \$269,000, \$246,000 and \$210,000, respectively.

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Aero Systems Engineering, Inc.

Notes to Financial Statements (continued)

10. RELATED PARTY TRANSACTIONS

At December 31, 2000 and 1999, Celsius Inc. owned 3,522,073 shares of the Company's common stock. This amount represents 80% of the voting shares outstanding. Celsius Inc. is a wholly-owned subsidiary of Saab AB, a Swedish company.

Celsius Inc. and its affiliated companies provide certain administrative support services to the Company and the Company is charged a fee for such services.

Such fees with affiliates are summarized as follows:

	YEAR ENDED DECEMBER 31	
	2000	1999
Interest expense	\$ 150,000	\$ 131,000
Administrative charges	50,000	59,000

11. SEGMENT INFORMATION

The Company operates primarily in one business segment relating to engine and aerodynamic test facilities. This segment represented more than 90% of revenue, operating profit and identifiable assets during 2000. The Company's operations

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are structured to achieve maximum overall corporate objectives. As a result, significant inter-dependencies and overlaps exist among the Company's operating units.

Revenues by geographic area are summarized as follows:

	2000	1999	
United States	\$16,578,706	\$18,194,016	\$
Foreign countries	14,067,408	12,867,066	-
	\$30,646,114	\$31,061,082	\$
	=====	=====	=====

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Aero Systems Engineering, Inc.

Notes to Financial Statements (continued)

11. SEGMENT INFORMATION (CONTINUED)

The Company had three customers accounting for 28%, 23% and 15% of revenues during the year ended December 31, 2000, three customers accounting for 25%, 20% and 11% of sales in the year ended December 31, 1999, and two customers accounting for 21% and 19% of sales in the year ended December 31, 1998.

12. QUARTERLY RESULTS (UNAUDITED)

Summary data relating to the results of operations for each quarter of the years ended December 31, 2000 and 1999 are as follows:

	THREE MONTHS ENDED			
	MARCH 31	JUNE 30	SEPTEMBER 30	DECEMBER 31
2000				
Earned revenue	\$6,760,000	\$8,078,000	\$8,751,000	\$7,000,000
Gross profit	1,393,000	1,832,000	1,734,000	1,800,000
Net (loss) income	(466,000)	251,000	340,000	200,000
Net (loss) income per common share	\$ (.11)	\$.06	\$.08	\$.05
1999				
Earned revenue	\$6,396,000	\$8,715,000	\$7,841,000	\$8,100,000
Gross profit	961,000	1,070,000	1,850,000	1,500,000
Net (loss) income	(476,000)	(454,000)	389,000	(100,000)
Net (loss) income per common share	\$ (.11)	\$ (.05)	\$.05	\$ (.01)

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Aero Systems Engineering, Inc.
(Registrant)

March 12, 2001

Date

By /s/ CHARLES LOUX

Charles Loux, President and Chief
Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report is signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

March 12, 2001

Date

/s/ CHARLES LOUX

Charles Loux, President and Chief
Executive Officer, Director

March 13, 2001

Date

/s/ CHRISTER PERSSON

Christer Persson, Chairman of the
Board

March 12, 2001

Date

/s/ A. L. MAXSON

A. L. Maxson, Director

March 13, 2001

Date

/s/ LEON E. RING

Dr. Leon Ring, Director

March 13, 2001

Date

/s/ RICHARD A. HOEL

Richard A. Hoel, Director

March 12, 2001

Date

/s/ STEVEN R. HEDBERG

Steven R. Hedberg, Chief Financial
Officer