AMERICAN SCIENCE & ENGINEERING, INC.
Form 10-Q
November 10, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

OR

o 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 1-6549

American Science and Engineering, Inc.

(Exact name of Registrant as specified in its charter)

Massachusetts	**04-2240991**
(State or other jurisdiction of	(I.R.S. Employer
incorporation or organization)	Identification No.)
829 Middlesex Turnpike	
Billerica, Massachusetts	**01821**
(Address of principal executive offices)	(Zip Code)

(978) 262-8700

(Registrant s telephone number, including area code)

(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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	o	Accelerated filer	x
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes o No x

The number of shares of the registrant s common stock, $0.66 2/3 par value, outstanding as of November 3, 2014 was 7,866,168.

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PART I FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

AMERICAN SCIENCE AND ENGINEERING, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except share and per share amounts)	**September 30, 2014**	**March 31, 2014**
Assets		
Current assets:		
Cash and cash equivalents	$ 39,829	$ 62,143
Restricted cash and investments	13,474	14,603
Short-term investments, at fair value	76,359	88,649
Accounts receivable, net of allowances of $343 and $323 at September 30, 2014 and March 31, 2014, respectively	29,419	34,317
Unbilled costs and fees	5,763	2,491
Inventories, net	45,200	32,935
Prepaid expenses and other current assets	10,441	5,459
Deferred income taxes	4,775	4,775
Total current assets	225,260	245,372
Building, equipment and leasehold improvements, net	10,866	12,969
Restricted cash and investments	716	313
Deferred income taxes	6,318	6,318
Other assets, net	993	539
Total assets	$ 244,153	$ 265,511
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 3,856	$ 10,618
Accrued salaries and benefits	8,308	10,805
Accrued warranty costs	186	404
Accrued income taxes		2,338
Deferred revenue	11,360	10,934
Customer deposits	22,022	16,589
Current portion of lease financing liability	1,521	1,511
Other current liabilities	4,975	9,292
Total current liabilities	52,228	62,491
Lease financing liability, net of current portion	640	1,404
Deferred revenue	1,668	3,941
Other long-term liabilities	38	280
Total liabilities	54,574	68,116
Stockholders equity:		
Preferred stock, no par value, 100,000 shares authorized; no shares issued		
Common stock, $0.66 2/3 par value, 20,000,000 shares authorized; 7,930,618 and 7,884,015 shares issued and outstanding at September 30, 2014 and March 31, 2014, respectively	5,287	5,255
Capital in excess of par value	37,854	35,236

Accumulated other comprehensive income (loss), net		(16)		13
Retained earnings		146,454		156,891
Total stockholders equity		189,579		197,395
Total liabilities and stockholders equity	$	244,153	$	265,511

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

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AMERICAN SCIENCE AND ENGINEERING, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(Unaudited)

	Three Months Ended		Six Months Ended	
(In thousands, except per share amounts)	**September 30, 2014**	**September 30, 2013**	**September 30, 2014**	**September 30, 2013**
Net sales and contract revenues:				
Net product sales and contract revenues	$ 11,004	$ 22,208	$ 34,255	$ 43,488
Net service revenues	12,062	21,608	24,348	43,412
Total net sales and contract revenues	23,066	43,816	58,603	86,900
Cost of sales and contracts:				
Cost of product sales and contracts	6,531	14,341	18,829	26,894
Cost of service revenues	6,852	10,269	13,622	21,653
Total cost of sales and contracts	13,383	24,610	32,451	48,547
Gross profit	9,683	19,206	26,152	38,353
Expenses:				
Selling, general and administrative expenses	9,118	6,913	17,309	14,322
Research and development costs	6,418	5,172	12,424	9,586
Total operating expenses	15,536	12,085	29,733	23,908
Operating income (loss)	(5,853)	7,121	(3,581)	14,445
Other income (expense):				
Interest and investment income	87	75	165	169
Interest expense	(9)	(14)	(19)	(29)
Other, net	(99)	(56)	(252)	(143)
Total other income (expense)	(21)	5	(106)	(3)
Income (loss) before provision for (benefit from) income taxes	(5,874)	7,126	(3,687)	14,442
Provision for (benefit from) income taxes	(1,968)	2,387	(1,235)	4,838
Net income (loss)	$ (3,906)	$ 4,739	$ (2,452)	$ 9,604
Other comprehensive income (loss):				
Unrealized gain (loss) on available for sale securities (net of tax)	(15)	60	(29)	34
Comprehensive income (loss)	$ (3,921)	$ 4,799	$ (2,481)	$ 9,638
Income (loss) per share - Basic	$ (0.49)	$ 0.61	$ (0.31)	$ 1.23
Income (loss) per share - Diluted	$ (0.49)	$ 0.60	$ (0.31)	$ 1.22
Weighted average shares Basic	7,917	7,820	7,904	7,831
Weighted average shares Diluted	7,917	7,851	7,904	7,866
Dividends declared per share	$ 0.50	$ 0.50	$ 1.00	$ 1.00

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

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AMERICAN SCIENCE AND ENGINEERING, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	For the Six Months Ended	
	September 30,	September 30,
(In thousands)	**2014**	**2013**
Cash flows from operating activities:		
Net income (loss)	$ (2,452)	$ 9,604
Adjustments to reconcile net income (loss) to net cash provided by (used for) operating activities:		
Depreciation and amortization	2,605	2,613
Provisions for contracts, inventory and accounts receivable reserves	(270)	1,543
Amortization of bond premium	540	855
Deferred income taxes		1,894
Stock compensation expense	1,770	641
Changes in assets and liabilities:		
Accounts receivable	4,878	7,490
Unbilled costs and fees	(3,272)	5
Inventories	(11,534)	(4,332)
Prepaid expenses and other assets	(5,436)	1,640
Accounts payable	(6,762)	2,873
Accrued income taxes	(2,338)	(2,094)
Customer deposits	5,433	12,731
Deferred revenue	(1,847)	(3,077)
Accrued expenses and other liabilities	(7,274)	(3,756)
Net cash (used for) provided by operating activities	(25,959)	28,630
Cash flows from investing activities:		
Purchases of short-term investments	(29,212)	(18,311)
Proceeds from sales and maturities of short-term investments	40,933	57,534
Purchases of property and equipment, net	(943)	(1,249)
Net cash provided by investing activities	10,778	37,974
Cash flows from financing activities:		
Decrease (increase) in restricted cash and investments	726	(1,222)
Proceeds from exercise of stock options	888	1,497
Repurchase of shares of common stock		(12,306)
Repayment of leasehold financing liability	(754)	(742)
Payment of common stock dividend	(7,993)	(7,800)
Reduction of income taxes paid due to the tax benefit from employee stock option expense		20
Net cash used for financing activities	(7,133)	(20,553)
Net (decrease) increase in cash and cash equivalents	(22,314)	46,051
Cash and cash equivalents at beginning of period	62,143	40,418
Cash and cash equivalents at end of period	$ 39,829	$ 86,469

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

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AMERICAN SCIENCE AND ENGINEERING, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. GENERAL

The condensed consolidated financial statements include the accounts of American Science and Engineering, Inc. and its wholly owned subsidiaries (the Company). All significant intercompany transactions and balances have been eliminated.

The unaudited condensed consolidated financial statements have been prepared in accordance with the requirements of Form 10-Q and consequently do not include all disclosures required by Form 10-K. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes included in the Company s Annual Report on Form 10-K for the fiscal year ended March 31, 2014, or fiscal 2014, as filed with the Securities and Exchange Commission on June 6, 2014.

The unaudited condensed consolidated financial statements, in the opinion of management, include all necessary adjustments, consisting solely of normal recurring adjustments, to present fairly the Company s financial position, results of operations and cash flows. These results are not necessarily indicative of the results to be expected for the entire year.

Nature of Operations

The Company develops, manufactures, markets, and sells X-ray inspection and other detection products for homeland security, force protection, and other critical defense applications. The Company provides maintenance, warranty, engineering, and training services related to these products. The Company has one reporting segment, X-ray screening products.

Significant Accounting Policies

For systems that are produced in a standard manufacturing operation and have shorter order to delivery cycles, the Company recognizes sales when title passes and when other revenue recognition criteria (such as transfer of risk and customer acceptance) are met. Revenues on cost reimbursable and custom long-term fixed price contracts are generally recorded as costs are incurred using the percentage of completion method.

Occasionally, the Company receives requests from customers to hold product being purchased for a valid business purpose. The Company recognizes revenue for such arrangements provided the transaction meets, at a minimum, the following criteria: a valid business purpose for the arrangement exists; risk of ownership of the purchased product has transferred to the buyer; there is a fixed delivery date that is reasonable and consistent with the buyer s business purpose; the product is ready for shipment; the Company has no continuing performance obligation in regards to the product and the product has been segregated from the Company s inventories and cannot be used to fill other orders received. There was no product being held under such arrangements at September 30, 2014 or March 31, 2014.

The other significant accounting policies followed by the Company and its subsidiaries in preparing its consolidated financial statements are set forth in Note 1 to the consolidated financial statements included in its Form 10-K for the year ended March 31, 2014. There have been no changes to the Company s critical accounting policies during the six months ended September 30, 2014.

Stock Repurchase Program

On May 7, 2013, the Board of Directors announced the approval of its fifth Stock Repurchase Program which authorized the Company to repurchase up to an additional $35 million of shares of its common stock from time to time on the open market or in privately negotiated transactions.

During the six months ended September 30, 2014, the Company made no stock repurchases. As of September 30, 2014, the remaining balance available under our fifth Stock Repurchase Program was $35,000,000.

Since September 30, 2014, the Company has repurchased 65,200 shares of its common stock at an average price of $48.33.

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Dividends

	Three Months Ended		Six Months Ended	
(In thousands)	**September 30, 2014**	**September 30, 2013**	**September 30, 2014**	**September 30, 2013**
Dividends declared	$ 0.50	$ 0.50	$ 1.00	$ 1.00
Dividends paid	$ 0.50	$ 0.50	$ 1.00	$ 1.00

On November 10, 2014, the Company declared a cash dividend of $0.50 per share. The dividend will be paid on December 2, 2014 to all shareholders of record at the close of business on November 25, 2014. Future dividends will be declared at the discretion of the Board of Directors and will depend upon such factors as the Board of Directors deems relevant.

Concentrations of Credit Risk

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist primarily of cash and cash equivalents, restricted cash, short-term investments and accounts and unbilled receivables. At times, the Company maintains cash balances in excess of insured limits. The Company maintains its cash and cash equivalents with major financial institutions. The Company s credit risk is managed by investing its cash in investment grade corporate debentures/bonds, U.S. government agency bonds, commercial paper, U.S. treasury bills, money market funds, and certificates of deposit.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue From Contracts With Customers*, which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The ASU is based on the principle that an entity should recognize revenue in an amount that reflects the consideration to which an entity expects to be entitled in exchange for the goods or services transferred to its customers. The ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to fulfill a contract. Entities have the option of using either a full retrospective or a modified retrospective approach for the adoption of the new standard. The guidance is effective for the interim and annual periods beginning on or after December 15, 2016 (early adoption is not permitted). The Company is currently assessing the impact that this standard will have on its consolidated financial statements.

2. ACCOUNTING FOR STOCK-BASED COMPENSATION

The Company accounts for stock-based awards made to its employees and Board of Directors in accordance with Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) 718, *Compensation Stock Compensation*, which requires the measurement and recognition of all compensation costs for stock-based awards made to employees and the Board of Directors based upon fair value over the requisite service period for awards expected to vest.

The Company recognized $991,000 and $333,000 of stock-based compensation costs for the three months ended September 30, 2014 and September 30, 2013, respectively. The Company recognized $1,770,000 and $641,000 of stock-based compensation costs for the six months ended September 30, 2014 and September 30, 2013, respectively. The income tax benefit recognized related to the compensation costs for the three months ended September 30, 2014 and September 30, 2013 was approximately $332,000 and $112,000 respectively. The income tax benefit recognized related to the compensation costs for the six months ended September 30, 2014 and September 30, 2013 was approximately $593,000 and $211,000, respectively.

The following table summarizes stock-based compensation costs included in the Company s consolidated statements of operations and comprehensive income (loss):

	Three Months Ended		Six Months Ended	
(In thousands)	**September 30, 2014**	**September 30, 2013**	**September 30, 2014**	**September 30, 2013**
Cost of revenues	$ 297	$ 104	$ 523	$ 217
Selling, general and administrative	694	229	1,247	424
Total share-based compensation expense before tax	$ 991	$ 333	$ 1,770	$ 641

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Stock Option and Other Compensation Plans

The Company has various stock option and other compensation plans for directors, officers, and employees. The Company had the following stock plans outstanding as of September 30, 2014: the 2002 Combination Plan, the 2003 Stock Plan for Non-Employee Directors, the 2005 Equity and Incentive Plan and the 2014 Equity and Incentive Plan. There are 513,000 shares remaining available for issuance under these plans. Vesting periods are at the discretion of the Board of Directors and typically range from one to three years. Certain of the options granted vest upon the achievement of certain performance based goals as well as service time incurred. Options under these plans are granted at fair market value and have a term of ten years from the date of grant.

Stock Options

The following tables summarize stock option activity for the six months ended September 30, 2014:

	Number of Shares	Weighted Average Exercise Price ($)	Weighted Average Contractual Life (years)	Aggregate Intrinsic Value
Options outstanding at March 31, 2014	224,964	$ 62.75	3.57	
Grants				
Exercises	(22,224)	39.90		$ 588,000
Cancellations	(906)	61.40		
Options outstanding at September 30, 2014	201,834	$ 65.27	3.29	
Options exercisable at September 30, 2014	201,834			

Information related to the stock options outstanding as of September 30, 2014 is as follows:

Range of Exercise Prices	Number of Shares	Weighted-Average Remaining Contractual Life (years)	Weighted-Average Exercise Price ($)	Exercisable Number of Shares	Exercisable Weighted-Average Exercise Price ($)
$ 46.68-$60.00	36,933	1.01	$ 52.76	36,933	$ 52.76
$ 60.01-$75.82	164,901	3.80	68.07	164,901	68.07
$ 46.68-$75.82	201,834	3.29	$ 65.27	201,834	$ 65.27

The Company deems the Black-Scholes option pricing model as the most appropriate method for determining the estimated fair value of stock-based awards. The Black-Scholes method of valuation requires several assumptions: (1) the expected term of the stock-based award; (2) the expected future stock volatility over the expected term; (3) a risk-free interest rate; and (4) the expected dividend yield. The expected term represents the expected period of time that the Company believes the options will be outstanding based on historical information. Estimates of expected future stock price volatility are based on the historic volatility of the Company s common stock and the risk-free interest rate is based on the U.S. Zero-Bond rate. The expected dividend yield is based on the assumption that the Company would continue paying dividends on its common stock at the same rate for the foreseeable future.

There were no options granted in the six month periods ended September 30, 2014 or September 30, 2013.

As of September 30, 2014, there was no remaining unrecognized compensation cost related to options granted.

Restricted Stock and Restricted Stock Units

The Company has instituted long-term incentive plans for certain key employees. These plans call for the issuance of restricted

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stock, restricted stock units, restricted stock options, and/or cash incentives which vest or are paid upon the achievement of certain performance-based goals as well as service time incurred. Restricted stock and restricted stock units may also be granted to other employees with vesting periods that range from one to three years. In addition, annually the non-employee directors are granted restricted stock. Restricted stock shares granted to our non-employee directors vest on a pro-rata basis, based on service time performed over a one-year period. The fair values of the restricted stock and restricted stock unit awards are equal to the market price per share of the Company s common stock on the date of grant.

Non-vested restricted stock and restricted stock unit awards are subject to the risk of forfeiture until the fulfillment of specified conditions. As of September 30, 2014, there was $4,320,000 of total unrecognized compensation costs related to non-vested restricted stock and restricted stock unit awards granted under the Company s stock plans. These costs are expected to be recognized over a weighted average period of 1.15 years.

The following table summarizes the status of the Company s non-vested restricted stock and restricted stock unit awards for the six months ended September 30, 2014:

	Number of Shares	Weighted Average Grant Date Fair Value ($)
Outstanding at March 31, 2014	72,000	$ 61.30
Granted	64,950	63.84
Vested	(26,028)	61.19
Forfeited	(7,009)	61.64
Outstanding at September 30, 2014	103,913	$ 62.89

3. INVENTORIES

Inventories consist of material, labor and manufacturing overhead and are recorded at the lower of cost, using the weighted average cost method, or net realizable value. Excess manufacturing overhead costs attributable to idle facility expenses, freight, handling costs and wasted material (spoilage) attributable to abnormally low production volumes (levels that materially differ from budgeted production plans due primarily to changes in customer demand) are excluded from inventory and recorded as an expense in the period incurred.

The components of inventories at September 30, 2014 and March 31, 2014 were as follows:

(In thousands)	**September 30, 2014**	**March 31, 2014**
Raw materials, completed sub-assemblies, and spare parts	$ 20,033	$ 18,482
Work-in-process	20,401	13,199
Finished goods	4,766	1,254
Total	$ 45,200	$ 32,935

4. INCOME (LOSS) PER COMMON AND COMMON EQUIVALENT SHARE

Basic earnings (loss) per common share is computed by dividing net income (loss) available to common stockholders by the weighted average number of shares of common stock outstanding during the period. Share-based payment awards entitling holders to receive non-forfeitable dividends before vesting are considered participating securities and thus are included in the calculation of basic earnings per share under the two-class method. Diluted earnings per share include the dilutive impact of options, and restricted stock units using the average share price of the Company s common stock for the period. For the three months ended September 30, 2014 and September 30, 2013, common stock equivalents of 298,000 and 181,000 shares, respectively, are excluded from diluted earnings per share, as their effect is anti-dilutive. For the six months ended September 30, 2014 and September 30, 2013, common stock equivalents of 294,000 and 181,000 shares, respectively, are excluded from diluted earnings per share, as their effect is anti-dilutive.

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(In thousands except per share amounts)	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013	Six Months Ended September 30, 2014	Six Months Ended September 30, 2013
Income (Loss) Per Share				
Basic:				
Net income (loss)	$ (3,906)	$ 4,739	$ (2,452)	$ 9,604
Weighted average number of common shares outstanding basic	7,917	7,820	7,904	7,831
Net income (loss) per share basic	$ (0.49)	$ 0.61	$ (0.31)	$ 1.23
Diluted:				
Net income (loss)	$ (3,906)	$ 4,739	$ (2,452)	$ 9,604
Weighted average number of common shares outstanding	7,917	7,820	7,904	7,831
Assumed exercise of dilutive stock options and restricted stock units, using the treasury stock method		31		35
Weighted average number of common and potential common shares outstanding diluted	7,917	7,851	7,904	7,866
Net income (loss) per share diluted	$ (0.49)	$ 0.60	$ (0.31)	$ 1.22

5. LETTERS OF CREDIT

In the normal course of business, the Company may provide certain customers and potential customers with performance guarantees, which are generally backed by standby letters of credit. In general, the Company would only be liable for the amount of these guarantees in the event of default in the performance of its obligations, the probability of which management believes is low. As of September 30, 2014, the Company had outstanding $26,512,000 in standby letters of credit. These outstanding standby letters of credit are cash-secured at amounts ranging from 52% to 100% of the outstanding letters of credit, resulting in restricted cash and investments balance of $14,190,000 at September 30, 2014, of which $716,000 was considered long-term restricted cash and investments due to the expiration date of the underlying letters of credit.

6. FAIR VALUE MEASUREMENTS

The Company has categorized its financial assets, based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy as set forth below. If the inputs used to measure a financial instrument fall within different levels of the hierarchy, the categorization of such financial asset is based on the lowest level input that is significant to the fair value measurement of such instrument.

Financial assets are categorized based on the inputs to the valuation techniques as follows:

Level 1 - Financial assets whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market that the Company has the ability to access at the measurement date (examples include actively exchange-traded equity securities, listed derivatives, and most U.S. government and agency securities).

Level 2 - Financial assets whose values are based on quoted prices in markets where trading occurs infrequently or whose values are based on quoted prices of instruments with similar attributes in active markets. Level 2 inputs include the following:

- Quoted prices for identical or similar assets or liabilities in non-active markets;
- Inputs other than quoted prices that are observable for substantially the full term of the asset or liability; and
- Inputs that are derived principally from or corroborated by observable market data for substantially the full term of the asset or liability.

Level 3 - Financial assets whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect management s assumptions about the assumptions a market participant would use in pricing the asset or liability. The Company currently does not have any Level 3 financial assets or liabilities.

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The following table presents the financial assets that the Company measures at fair value on a recurring basis, based on the fair value hierarchy as of September 30, 2014 and March 31, 2014:

(In thousands)	September 30, 2014	March 31, 2014
Level 1 Financial Assets		
Money market funds	$ 34,762	$ 33,623
Treasury bills	17,721	17,722
Total Level 1 Financial Assets	52,483	51,345
Level 2 Financial Assets		
Corporate debentures/bonds	31,996	41,424
Commercial paper		6,193
Government agency bonds	26,642	26,660
Total Level 2 Financial Assets	58,638	74,277
Total cash equivalents and short-term investments	$ 111,121	$ 125,622

These investments are classified as available-for-sale and are recorded at their fair market values using the specific identification method. As of September 30, 2014, all of the Company s available-for-sale securities had contractual maturities of sixteen months or less. The Company had no material realized gains or losses on its available-for-sale securities for the three and six months ended September 30, 2014 and September 30, 2013, respectively. The unrealized holding gains or losses on these securities are included as a component of other comprehensive income (loss), as disclosed in the condensed consolidated statements of operations and comprehensive income (loss).

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2014:				
Short-term investments:				
Corporate debentures/bonds	$ 32,032	$ 1	$ (37)	$ 31,996
Government agency bonds	26,633	9		26,642
Treasury bills	17,704	17		17,721
Total short-term investments	$ 76,369	$ 27	$ (37)	$ 76,359
Cash equivalents:				
Money market funds	$ 34,762	$	$	$ 34,762
Total cash equivalents	$ 34,762	$	$	$ 34,762

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2014:				
Short-term investments:				
Corporate debentures/bonds	$ 38,076	$ 9	$ (11)	$ 38,074
Commercial paper	6,193			6,193
Government agency bonds	26,652	10	(2)	26,660
Treasury bills	17,708	14		17,722
Total short-term investments	$ 88,629	$ 33	$ (13)	$ 88,649
Cash equivalents:				
Money market funds	$ 33,623	$	$	$ 33,623
Corporate debentures/bonds	3,350			3,350
Total cash equivalents	$ 36,973	$	$	$ 36,973

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7. INCOME TAXES

The Company accounts for income taxes in accordance with FASB ASC 740, *Income Taxes,* and recognizes deferred income taxes based on the expected future tax consequences of differences between the financial statement basis and the tax basis of assets and liabilities, calculated using enacted tax rates in effect for the year in which the differences are expected to be reflected in the tax return. The Company evaluates the need for a valuation allowance against its net deferred tax assets at period end based upon its three year cumulative income and its projections of future income, and records a valuation allowance against any net deferred tax assets if it is more likely than not that they will not be realized.

The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for the years ending March 31, 2011 through 2013 and by various state taxing authorities for the years ending March 31, 2007 through 2013.

8. GUARANTEES

Certain of the Company s products carry a one-year warranty, the costs of which are accrued for at the time of shipment or delivery. Accrual rates are based upon historical experience for the trailing twelve months and management s judgment of future exposure. Warranty experience for the three and six months ended September 30, 2014 and 2013 was as follows:

	Three Months Ended		Six Months Ended	
(In thousands)	**September 30, 2014**	**September 30, 2013**	**September 30, 2014**	**September 30, 2013**
Warranty accrual - beginning of period	$ 246	$ 364	$ 404	$ 397
Accruals for warranties issued during the period	43	123	85	228
Adjustment of preexisting accrual estimates	(16)	(51)	(160)	(66)
Warranty costs incurred during the period	(87)	(91)	(143)	(214)
Warranty accrual end of period	$ 186	$ 345	$ 186	$ 345

9. LEASE COMMITMENTS

In March 2005, the Company renewed its lease agreement for its corporate headquarters and manufacturing facilities in Billerica, Massachusetts. As part of the lease agreement, the Company s landlord agreed to certain renovations to the Billerica facility including the construction of additional high bay manufacturing space. The Company was responsible for a portion of the construction costs and was deemed to be the owner of the building during the construction period under FASB ASC 840, *Leases.* In January 2007, the Company amended this lease agreement to expand its lease to include the remaining available space in the building. A total of $7,182,000 was capitalized to record the facility on its books with an offsetting credit to the lease financing liability. In addition, amounts paid for construction were capitalized to fixed assets and the landlord construction allowances of $6,009,000 were recorded as additional lease financing liability.

At the completion of the construction of the initial renovations in February 2006, the lease was reviewed for potential sale-leaseback treatment in accordance with FASB ASC 840-40, *Leases Sale-Leaseback Transactions*. Based on this review, it was determined that the lease did not qualify for sale-leaseback treatment in accordance with FASB ASC 840-40. As a result, the building and tenant improvement and associated lease financing liabilities remain on the Company s books. The lease financing liability is being amortized over the original lease term based on the payments designated in the agreement and the building and tenant improvement assets are being depreciated on a straight line basis over the lesser of their useful lives or the lease term.

In October 2014, the Company entered into an amendment to the lease agreement for the Billerica facilities extending the term of the lease through February 28, 2023 with an adjusted rent schedule commencing October 1, 2014.

10. COMMITMENTS AND CONTINGENCIES

Deferred Revenue

The Company offers extended warranty and service contracts to its customers. These contracts typically cover a period of one to five years, and include advance payments that are recorded as deferred revenue. Revenue is recognized as services are performed over the life of the contract, which represents the period over which these revenues are earned. Costs associated with these extended warranty and service contracts are expensed to cost of goods sold as incurred.

ITEM 2 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties. For this purpose, any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Exchange Act of 1934. Without limiting the foregoing, the words believes , anticipates , plans , expects , intends , should and similar expressions are intended to identify forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties, and assumptions that are difficult to predict, and you should not place undue reliance on our forward-looking statements. The factors discussed under Item 1A. Risk Factors , among others, could cause actual results to differ materially from those indicated by forward-looking statements made herein and presented elsewhere by management from time to time. We expressly disclaim any obligation to update or alter our forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

Overview

American Science and Engineering, Inc. develops and manufactures X-ray inspection systems for homeland security, force protection and other critical defense applications. We provide maintenance, warranty, engineering, and training related to these products.

Our primary technologies are Z Backscatter technology which is used to detect explosives, illegal drugs, and other contraband even when concealed in complex backgrounds; and other technologies that expand the detection capability of our products beyond the material discrimination features of the Z Backscatter technology to include the penetration capability of high-energy transmission X-rays for dense cargos and/or other detection techniques.

Net sales and contract revenues for the second quarter of fiscal year ending March 31, 2015, or fiscal 2015, decreased to $23,066,000 compared to revenues of $43,816,000 for the second quarter of fiscal 2014. We reported an operating loss of $5,853,000 for the second quarter of fiscal 2015 compared to operating income of $7,121,000 for the second quarter of fiscal 2014. Net losses for the second quarter of fiscal 2015 were $3,906,000 ($0.49 loss per share, on a diluted basis) compared to net income of $4,739,000 ($0.60 per share, on a diluted basis) for the second quarter of fiscal 2014. These results represent a 47% decrease in revenues, an $8,645,000 decrease in net income (loss), and a $1.09 decrease in earnings (loss) per share when compared to results for the second quarter of fiscal 2014.

Net sales and contract revenues for the first six months of fiscal 2015 decreased to $58,603,000 compared to revenues of $86,900,000 for the first six months of fiscal 2014. We reported an operating loss of $3,581,000 for the first six months of fiscal 2015 compared to operating income of $14,445,000 for the first six months of fiscal 2014. Net losses for the first six months of fiscal 2015 were $2,452,000 ($0.31 loss per share, on a diluted basis) compared to net income of $9,604,000 ($1.22 earnings per share, on a diluted basis) for the first six months of fiscal 2014. These results represent a 33% decrease in revenues, a $12,056,000 decrease in net income (loss), and a $1.53 decrease in earnings (loss) per share when compared to results for the first six months of fiscal 2014.

The following table presents net sales and contract revenues by product and service categories:

	Three Months Ended		Six Months Ended	
(In thousands)	**September 30, 2014**	**September 30, 2013**	**September 30, 2014**	**September 30, 2013**
Cargo Inspection Systems	$ 4,035	$ 8,911	$ 13,181	$ 22,529
Mobile Cargo Inspection Systems	2,772	8,434	14,335	13,242
Parcel and Personnel Screening Inspection Systems	1,534	2,099	2,299	3,941
Other product sales and contract revenue	2,663	2,764	4,440	3,776
Total net product sales and contract revenues	11,004	22,208	34,255	43,488
Net service revenues	12,062	21,608	24,348	43,412
Total net sales and contract revenues	$ 23,066	$ 43,816	$ 58,603	$ 86,900

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Critical Accounting Policies

We believe that several accounting policies are important to understanding our historical and future performance. We refer to these policies as critical because these specific areas generally require us to make judgments and estimates about matters that are uncertain at the time we make the estimate, and different estimates which also would have been reasonable could have been used, which would have resulted in different financial results.

The critical accounting policies we identified in our most recent Annual Report on Form 10-K for the fiscal year ended March 31, 2014 are policies related to revenue recognition, inventories and related allowances for obsolete and excess inventory, and income taxes. It is important that the discussion of our operating results that follows be read in conjunction with the critical accounting policies disclosed in our Annual Report on Form 10-K, as filed with the Securities and Exchange Commission on June 6, 2014. There have been no changes to our critical accounting policies during the three month period ended September 30, 2014.

Results of Operations

Net sales and contract revenues for the second quarter of fiscal 2015 decreased by $20,750,000 to $23,066,000 compared to the net sales and contract revenues of $43,816,000 for the corresponding period in the prior fiscal year. Product sales and contract revenues decreased by $11,204,000 from the prior year due to a decrease of $5,662,000 in Mobile Cargo Inspection Systems revenues as shipments scheduled for the quarter were postponed due to contract issues and political unrest in certain destination locations. In addition, Cargo Inspection Systems revenues decreased by $4,876,000 due to lower unit volume resulting from continued installation delays due to customer s lack of readiness and a decline in bookings. Net service revenues decreased by $9,546,000 to $12,062,000 compared to the second quarter of fiscal 2014 due primarily to the reduction in the number of systems under support contracts as a result of the continued withdrawal of U.S. forces from Iraq and Afghanistan. Additionally, certain of these contracts have shifted from full service, fixed price contracts to variable labor only contracts resulting in lower revenue.

Net sales and contract revenues for the six months of fiscal 2015 decreased by $28,297,000 to $58,603,000 compared to the net sales and contract revenues of $86,900,000 for the corresponding period in the prior fiscal year. Product sales and contract revenues decreased by $9,233,000 from the prior year due to a decrease in Cargo Inspection Systems revenues of $9,348,000 and Parcel and Personnel Inspection System revenues of $1,642,000 due to lower unit volume. This decrease was offset in part by an increase of $1,093,000 in Mobile Cargo Inspection Systems revenues. Net service revenues decreased by $19,064,000 to $24,348,000 compared to the first six months of fiscal 2014 due primarily to the reduction in the number of systems under support contracts as a result of the continued withdrawal of U.S. forces from Iraq and Afghanistan. Additionally, certain of these contracts have shifted from full service, fixed price contracts to variable labor only contracts resulting in lower revenue.

Total cost of sales and contract revenues for the second quarter of fiscal 2015 decreased by $11,227,000 to $13,383,000 as compared to the corresponding period a year ago. Cost of product sales and contract revenues decreased by $7,810,000 to $6,531,000 as compared to the corresponding period a year ago. Cost of product sales and contract revenues represented 59% of revenues versus 65% of revenues for the corresponding period in the prior year. This resulted in an increase in gross margin percentage from the corresponding period a year ago as we accrued in the prior period $1.5 million in program costs overruns and anticipated losses on fixed price contracts which impacted gross margin by seven percentage points. In the corresponding quarter of fiscal 2015, we accrued $304,000 in severance costs related to a workforce reduction which negatively impacted gross margin on products by three percentage points. The cost of service revenues for the second quarter of fiscal 2015 decreased by $3,417,000 to $6,852,000 as compared to the corresponding period a year ago. Cost of service revenues increased to

57% of revenues from 48% of revenues in the corresponding period. The decline in margins in the second quarter of fiscal 2015 is attributable primarily to $546,000 in costs accrued related to a contract default by a subcontractor as well as the accrual of $294,000 in severance costs related to the workforce reduction which impacted gross margin on services by two percentage points.

Total cost of sales and contract revenues for the first six months of fiscal 2015 decreased by $16,096,000 to $32,451,000 as compared to the corresponding period a year ago. Cost of product sales and contract revenues decreased by $8,065,000 to $18,829,000 as compared to the corresponding period a year ago. Cost of product sales and contract revenues represented 55% of revenues versus 62% of revenues for the corresponding period in the prior year. This resulted in an increase in gross margin percentage from the

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corresponding period a year ago as we accrued in the prior year period $1.5 million in program costs overruns and anticipated losses on fixed price contracts which impacted gross margin by three percentage points. In addition, there was a shift in the product mix from the corresponding period in fiscal 2015 with a greater percentage of revenues deriving from Mobile Cargo products which historically earn higher margins than the other product groups. The cost of service revenues for the first six months of fiscal 2015 decreased by $8,031,000 to $13,622,000 as compared to the corresponding period a year ago. Cost of service revenues increased to 56% of revenues from 50% of revenues in the corresponding period. The decline in gross margin percentage in the first six months of fiscal 2015 as compared to the corresponding prior period is attributable to the $546,000 in costs related to the contract default by a subcontractor noted above and an increase in labor costs as a percentage of revenue to support systems under contract.

Selling, general and administrative expenses for the second quarter of fiscal 2015 increased by $2,205,000 to $9,118,000 as compared to the corresponding period a year ago. Selling, general and administrative expenses represented 40% of revenues in the current period compared to 16% for the corresponding period in the prior year. The increase in selling, general and administrative expenses from the prior year period was primarily the result of the accrual of severance costs of $552,000, an increase in legal costs of $533,000 related to intellectual property and other contract related matters, an increase in payroll and payroll related costs of $330,000 on increased headcount, an increase in marketing related expenses of $268,000 related to the proposal related efforts during the quarter, an increase in consulting expenses of $115,000 and an increase in travel related expenses of $98,000 as compared to the prior year.

Selling, general and administrative expenses for the first six months of fiscal 2015 increased by $2,987,000 to $17,309,000 as compared to the corresponding period a year ago. Selling, general and administrative expenses represented 30% of revenues in the current period compared to 17% for the corresponding period in the prior year. The increase in selling, general and administrative expenses from the prior year period was primarily the result of an increase in incentive compensation expense of $674,000, an increase in payroll and payroll related costs of $543,000 on increased headcount, an increase in marketing related expenses of $498,000 related to the launch of our new MINI Z product, as well as an increase in proposal related efforts during the period, an increase in travel related expenses of $248,000, an increase in legal costs of $223,000 related to intellectual property and other contract related matters, and an increase in consulting expenses of $140,000 as compared to the prior year. In addition, during the six months ended September 30, 2014, we accrued severance costs of $552,000 impacting selling, general and administrative expenses primarily related to the workforce reduction effected at the end of the second quarter of fiscal 2015 equal to approximately 10% of the workforce.

Company funded research and development expenses for the second quarter of fiscal 2015 increased by $1,246,000 to $6,418,000 as compared to the corresponding period a year ago. Research and development expenses represented 28% of revenues in the current quarter compared to 12% for the corresponding period in the prior year. Research and development expenses increased as compared to the prior year period as engineering resources devoted to the completion of a significant custom-build revenue program at an international port during the prior year, returned to research and development activities, and our average engineering headcount also increased as compared to the corresponding prior year period. In addition, the workforce reduction effected at the end of the second quarter of fiscal 2015 resulted in additional research and development expense of $350,000 during the period.

Company funded research and development expenses for the first six months of fiscal 2015 increased by $2,838,000 to $12,424,000 as compared to the corresponding period a year ago. Research and development expenses represented 21% of revenues in the current quarter compared to 11% for the corresponding period in the prior year. Research and development expenses increased as compared to the prior year period as engineering resources devoted to the completion of a significant custom-build revenue program at an international port during the prior year, returned to research and development activities, and our average engineering headcount also increased as compared to the corresponding prior year period. In addition as noted above the workforce reduction effected at the end of the second quarter of fiscal 2015 resulted in additional research and development expense of $350,000 during the period.

Other income (expense) was ($21,000) of expense for the second quarter of fiscal 2015 as compared to $5,000 of income for the corresponding period a year ago. The increase in other expense was the result of investment income increases offset by an increase of $41,000 in foreign currency transaction losses as compared to the prior year.

Other income (expense) was ($106,000) of expense for the first six months of fiscal 2015 as compared to ($3,000) of expense for the corresponding period a year ago. The increase in other expense was the result of reduced investment income as well as an increase of $95,000 in foreign currency transaction losses as compared to the prior year.

We reported a pre-tax loss of $5,874,000 in the second quarter of fiscal 2015 as compared to pre-tax income of $7,126,000 in the corresponding period due to the factors described above. We reported a pre-tax loss of $3,687,000 in the first six months of fiscal 2015 as compared to pre-tax income of $14,442,000 in the corresponding period due to the factors described above.

Our effective tax rate was 33.5% for all periods presented.

Liquidity and Capital Resources

Our sources of liquidity include, but are not limited to, our cash flows from operations and cash received from stock issuances related to option exercises. We believe that our operating cash flows and cash and investments on hand are sufficient to fund our working capital requirements, capital expenditures, income tax obligations, dividends to our shareholders and performance guarantee collateralizations for the foreseeable future and also to fund stock repurchases as desired.

Summary of Cash Activities

Cash and cash equivalents decreased by $22,314,000 to $39,829,000 at September 30, 2014 compared to $62,143,000 at March 31, 2014. Cash inflows for the period consisted primarily of:

1) net loss of $2,452,000 for the period offset by $4,645,000 in non-cash expenditures which included depreciation expense, stock based compensation, amortization of bond premiums, and provisions for contract, inventory and accounts receivable reserves;

2) net proceeds from sales and maturities of short-term investments of $11,721,000;

3) an increase of $5,433,000 in customer deposits during the period due to the timing of milestone payments on certain fixed price contracts; and

4) a decrease of $4,878,000 in accounts receivable from year end.

Offsetting these inflows were cash outflows including:

1) the payment of $7,993,000 in common stock dividends during the period as part of our quarterly dividend program;

2) an increase in inventories of $11,534,000 attributable to delays in shipments of finished goods and inventory buildup to fulfill projected and current orders;

3) a decrease in accrued expenses and other liabilities of $7,274,000 due primarily to the payment of incentive compensation, agent commissions and project-related costs accrued for at year end;

4) an increase in prepaid expenses and other assets of $5,436,000 attributable primarily to the payment of estimated taxes;

5) a decrease in accounts payable of $6,762,000 from the year end; and

6) a decrease in accrued income taxes of $2,338,000 due the payment of estimated taxes related to the year-end tax provision.

In the normal course of business, we may provide certain customers and potential customers with performance guarantees, which are generally backed by standby letters of credit. In general, we would only be liable for the amount of these guarantees in the event of default in the performance of our obligations; the probability of which management believes is low. As of September 30, 2014, we had outstanding $26,512,000 in standby letters of credit. These outstanding standby letters of credit are cash-secured at amounts ranging from 52% to 100% of the outstanding letters of credit, resulting in a restricted cash and investments balance of $14,190,000 at September 30, 2014, of which $716,000 was considered long-term restricted cash and investments due to the expiration date of the underlying letters of credit.

ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There were no material changes in the quantitative and qualitative information about market risk since the end of our most recent fiscal year. For further information, see Item 7A of our Annual Report on Form 10-K for the fiscal year ended March 31, 2014, as filed with the Securities and Exchange Commission on June 6, 2014.

ITEM 4 CONTROLS AND PROCEDURES

a) Evaluation of disclosure controls and procedures

As of the end of the period covered by this report, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we reviewed and evaluated the effectiveness of our Company s disclosure

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controls and procedures pursuant to Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 as amended (the Exchange Act). Based upon their evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by the Company in the reports filed and submitted by it under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms, and to provide reasonable assurance that information required to be disclosed by us in such reports is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

b) Changes in internal control over financial reporting

There have been no changes in our internal control over financial reporting as such term is defined in Rule 13a-15(f) and 15d-15(f) of the Exchange Act during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1A RISK FACTORS

You should carefully review and consider the information regarding certain factors which could materially affect our business, financial condition or future results set forth under Item 1A. Risk Factors in our Form 10-K for the fiscal year ended March 31, 2014 as filed with the Securities and Exchange Commission on June 6, 2014. There have been no material changes from the factors disclosed in our Form 10-K for the year ended March 31, 2014, although we may disclose changes to such factors or disclose additional factors from time to time in our future filings with the Securities and Exchange Commission.

ITEM 2 UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On May 7, 2013, the Board of Directors announced the approval of a Stock Repurchase Program which authorizes us to repurchase up to $35.0 million of shares of its common stock from time to time on the open market or in privately negotiated transactions. We made no repurchases of equity securities in the quarter ended September 30, 2014.

ITEM 6 EXHIBITS

The exhibits listed on the Exhibit Index immediately following the signature page to this Quarterly Report on Form 10-Q are incorporated herein by reference, and are filed or furnished as part of this Quarterly Report on Form 10-Q.

The information required by Exhibit Item 11 (Statement re: Computation of Income per Common and Common Equivalent Share) may be found in Note 4 to the Unaudited Condensed Consolidated Financial Statements in this quarterly report.

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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.

AMERICAN SCIENCE AND ENGINEERING, INC.

Date: November 10, 2014

/s/ Kenneth J. Galaznik
Kenneth J. Galaznik
Senior Vice President, Chief Financial Officer and Treasurer (Principal Financial Officer)

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EXHIBIT INDEX

Exhibit Number		Description of Exhibits
10.1	*	Form of Non-Employee Director Restricted Stock Award Agreement under the 2014 Equity and Incentive Plan
10.2	*	Form of Restricted Stock Unit Grant Agreement under the 2014 Equity and Incentive Plan
10.3		Fifth Amendment to Lease of 829 Middlesex Turnpike, Billerica, Massachusetts
31.1		Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*
31.2		Certification by Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*
32.1		Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
32.2		Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
101		The following financial information from American Science and Engineering Inc. s Quarterly Report on Form 10-Q for the quarter ended September 30, 2014, formatted in XBRL (eXtensible Business Reporting Language) includes: (i) Condensed Consolidated Statements of Operations and Comprehensive Income for the three and six months ended September 30, 2014 and 2013, (ii) Condensed Consolidated Balance Sheets at September 30, 2014 and March 31, 2014, (iii) Condensed Consolidated Statements of Cash Flows for the six months ended September 30, 2014 and 2013, and (iv) the Notes to Condensed Consolidated Financial Statements.*

Filed herewith

* Management contract or compensatory plan