

AEROSONIC CORP /DE/  
Form 10-Q  
September 11, 2006

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

**(Mark One)**

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

**For the quarterly period ended July 28, 2006**

**OR**

**£ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the transition period from to**

**Commission file number 1-11750**

**AEROSONIC CORPORATION**

**(Exact name of registrant as specified in its charter)**

**Delaware**  
**(State or other jurisdiction of incorporation or  
organization)**

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

**1212 North Hercules Avenue**

**Clearwater, Florida 33765**

**(Address of principal executive offices and Zip Code)**

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

**Not Applicable**

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Large accelerated filer  Accelerated filer  Non-accelerated filer

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

As of September 8, 2006, the issuer had 3,568,939 shares of Common Stock outstanding, net of treasury shares.

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**PART I FINANCIAL INFORMATION**

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**PART I FINANCIAL INFORMATION**

**Forward-Looking Statements**

**THIS REPORT CONTAINS CERTAIN FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1933, AS AMENDED, AND SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED, WHICH ARE INTENDED TO BE COVERED BY THE SAFE HARBORS CREATED THEREUNDER. FORWARD-LOOKING STATEMENTS CAN BE IDENTIFIED BY THE USE OF FORWARD-LOOKING TERMINOLOGY SUCH AS MAY, WILL, SHOULD, EXPECT, ANTICIPATE, ESTIMATE, CONTINUE, PLANS, INTENDS AND V SIMILAR IMPORT. ALTHOUGH THE COMPANY BELIEVES THAT THE ASSUMPTIONS UNDERLYING THE FORWARD-LOOKING STATEMENTS CONTAINED HEREIN ARE REASONABLE, ANY OF THE ASSUMPTIONS COULD BE INACCURATE. THEREFORE, THE COMPANY S ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THE RESULTS ANTICIPATED IN THESE FORWARD-LOOKING STATEMENTS. ADDITIONALLY, ACTUAL RESULTS MIGHT BE AFFECTED BY CERTAIN FACTORS SET FORTH HEREIN IN MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS. THE COMPANY UNDERTAKES NO OBLIGATION TO UPDATE PUBLICLY ANY FORWARD-LOOKING STATEMENTS, WHETHER AS A RESULT OF NEW INFORMATION, FUTURE EVENTS OR OTHERWISE.**

**Table of Contents****ITEM 1 FINANCIAL STATEMENTS****AEROSONIC CORPORATION AND SUBSIDIARY****CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>July 28, 2006</b> <b>(unaudited)</b>	<b>January 31, 2006</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,217,000	\$ 3,106,000
Receivables, net of allowance for doubtful accounts of \$10,000		
and \$14,000	4,784,000	4,364,000
Income taxes receivable	2,000	226,000
Costs less estimated losses in excess of billings	-	420,000
Inventories	5,855,000	5,984,000
Prepaid expenses	398,000	446,000
Deferred income taxes	1,586,000	1,586,000
Total current assets	13,842,000	16,132,000
Property, plant and equipment, net	3,468,000	3,617,000
Deferred income taxes	307,000	307,000
Other assets, net	132,000	156,000
Total assets	\$ 17,749,000	\$ 20,212,000
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Long-term debt and notes payable due within one year	\$ 230,000	\$ 230,000
Accounts payable, trade	1,126,000	1,544,000
Compensation and benefits	903,000	834,000
Income taxes payable	15,000	20,000
Accrued expenses and other liabilities	1,775,000	1,895,000
Total current liabilities	4,049,000	4,523,000
Long-term debt and notes payable due after one year	2,449,000	2,564,000

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Other liabilities	100,000	46,000
Total liabilities	6,598,000	7,133,000
Commitments and contingencies		
Stockholders' equity:		
Common stock \$.40 par value: authorized 8,000,000 shares;		
issued 3,999,706 shares at July 28, 2006 and 3,992,601 shares		
at January 31, 2006; outstanding 3,568,939 shares at July		
28, 2006 and 3,927,358 shares at January 31, 2006	1,600,000	1,599,000
Additional paid-in capital	4,632,000	4,600,000
Retained earnings	8,082,000	7,576,000
Less treasury stock: 430,767 shares at July 28, 2006 and		
65,243 shares at January 31, 2006, at cost	(3,163,000)	(696,000)
Total stockholders' equity	11,151,000	13,079,000
Total liabilities and stockholders' equity	\$ 17,749,000	\$ 20,212,000

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

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

	<b>Three months ended</b>		<b>Six months ended</b>	
	<b>July 28, 2006</b>	<b>July 29, 2005</b>	<b>July 28, 2006</b>	<b>July 29, 2005</b>
Revenues, net	\$ 7,595,000	\$ 8,977,000	\$16,076,000	\$18,052,000
Cost of revenues	5,696,000	5,966,000	11,435,000	12,516,000
Gross profit	1,899,000	3,011,000	4,641,000	5,536,000
Selling, general and administrative expenses	1,968,000	2,175,000	4,099,000	3,988,000
Operating (loss) income	(69,000)	836,000	542,000	1,548,000
Other income (expense):				
Interest expense, net	(43,000)	(30,000)	(72,000)	(73,000)
Miscellaneous income	10,000	(15,000)	46,000	40,000
	(33,000)	(45,000)	(26,000)	(33,000)
(Loss) income before income taxes	(102,000)	791,000	516,000	1,515,000
Income tax benefit (expense)	25,000	(309,000)	(10,000)	(584,000)
Net (loss) income	\$ (77,000)	\$ 482,000	\$ 506,000	\$ 931,000
Basic (loss) earnings per share	\$ (0.02)	\$ 0.12	\$ 0.14	\$ 0.24
Diluted (loss) earnings per share	\$ (0.02)	\$ 0.12	\$ 0.14	\$ 0.24
Basic weighted average shares outstanding	3,562,739	3,921,019	3,656,933	3,921,019
Diluted weighted average shares outstanding	3,562,739	3,921,019	3,670,361	3,921,019

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





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

	<b>Six months ended</b>	
	<b>July 28, 2006</b>	<b>July 29, 2005</b>
<b>Cash flow from operating activities:</b>		
Net income	\$ 506,000	\$ 931,000
Adjustments to reconcile net income to net cash provided by operating activities:		
activities:		
Stock-based compensation	33,000	-
Depreciation	333,000	335,000
Amortization	7,000	13,000
(Gain) loss on the disposal of property	(33,000)	8,000
Changes in operating assets and liabilities:		
Receivables	(420,000)	(1,805,000)
Income taxes receivable and payable	219,000	1,083,000
Costs less estimated losses in excess of billings	420,000	1,210,000
Inventories	129,000	(369,000)
Prepaid expenses	48,000	(134,000)
Other assets	17,000	3,000
Accounts payable, trade	(418,000)	950,000
Compensation and benefits	69,000	(5,000)
Accrued expenses and other liabilities	(66,000)	26,000
Net cash provided by operating activities	844,000	2,246,000
<b>Cash flow from investing activities:</b>		
Proceeds from the sale of property	58,000	2,000
Capital expenditures	(209,000)	(201,000)
Net cash used in investing activities	(151,000)	(199,000)
<b>Cash flow from financing activities:</b>		
Purchase of treasury stock	(2,467,000)	-
Principal payments on long-term debt and notes payable	(115,000)	(128,000)
Net cash used in financing activities	(2,582,000)	(128,000)
	(1,889,000)	1,919,000

**Net (decrease) increase in cash and cash equivalents**

Cash and cash equivalents at beginning of period	3,106,000	840,000
Cash and cash equivalents at end of period	\$ 1,217,000	\$ 2,759,000

**Supplemental disclosure of cash flow information:**

Cash paid during the period for:

Interest	\$ 73,000	\$ 92,000
Income taxes	\$ 30,000	\$ -

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

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**AEROSONIC CORPORATION AND SUBSIDIARY**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

**Note 1 Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principles for interim financial reporting and with the instructions to Form 10-Q and in Regulation S-X of the U.S. Securities and Exchange Commission ( **SEC** ). Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The condensed consolidated balance sheet at January 31, 2006 has been derived from the audited consolidated financial statements, but does not include all of the disclosures required by generally accepted accounting principles. The financial statements are prepared on a consistent basis (including normal recurring adjustments) and should be read in conjunction with the consolidated financial statements and related notes contained in the Annual Report on Form 10-K for the fiscal year ended January 31, 2006 (the **2006 Form 10-K** ) that the Company filed with the SEC on March 28, 2006. Operating results for the three and six months ended July 28, 2006 are not necessarily indicative of the results that may be expected for the year ending January 31, 2007.

The Company has a January 31 fiscal year end. Accordingly, all references in this quarterly report on Form 10-Q to the second quarter mean the second quarter ended on the last Friday of July of the referenced fiscal year. For example, references to the second quarter of fiscal year 2007 mean the second quarter ended July 28, 2006.

**Note 2 Business**

The Company is principally engaged in one business segment, which is the manufacture and sale of aircraft instruments. The Company has three operating divisions in three locations. The two principal divisions are the Clearwater, Florida Instrument Division ( **Clearwater Instruments** ), which primarily manufactures both mechanical and digital altimeters, airspeed indicators, rate of climb indicators, microprocessor controlled air data test sets, and a variety of other flight instrumentation, and Avionics Specialties, Inc. ( **Avionics** ) in Earlysville, Virginia, which maintains three major product lines in the aircraft instrument segment: (1) angle of attack stall warning systems; (2) integrated multifunction probes, which are integrated air data sensors; and (3) other aircraft sensors and monitoring systems. In addition, the Company maintains a third division in Wichita, Kansas ( **Kansas Instruments** ) to support the Clearwater Instruments business. Kansas Instruments is the source inspection location for our Wichita customers and is the primary location for Clearwater Instruments repair business.

During the three months ended July 28, 2006, sales to The Boeing Company ( **Boeing** ) represented approximately 10% of total revenues. During the three months ended July 29, 2005, sales to Lockheed Martin Corporation ( **Lockheed** ) represented approximately 12% of total revenues and sales to Boeing represented approximately 10% of total revenues. During the six months ended July 28, 2006 and July 29, 2005, sales to Lockheed represented approximately 12% and 18%, respectively, of total revenues.

**Note 3 Inventories**

The Company values inventory at the lower of cost (using a method that approximates the first-in, first-out method) or net realizable value. Reviews of inventory quantities on hand have been conducted to determine if usage or sales history supports maintaining inventory values at full cost or if it has instead become necessary to record a provision

for slow moving, excess and obsolete inventory based primarily on estimated forecasts of product demand and production requirements for the subsequent twelve months and actual usage for the previous two years. During production, the Company uses standards to estimate product costs. These standards are reviewed and updated, generally monthly, by management. Differences between standard and actual costs have historically not been material.

Inventories at July 28, 2006 and January 31, 2006 consisted of the following:

	<b>July 28, 2006</b>	<b>January 31, 2006</b>
Raw materials	\$ 3,953,000	\$ 3,935,000
Work in process	2,248,000	2,436,000
Finished goods	134,000	121,000
Reserve for obsolete and slow moving inventory	(480,000)	(508,000)
	\$ 5,855,000	\$ 5,984,000

**Note 4 Joint Strike Fighter Development Program**

During fiscal 2003, the Company secured a long-term fixed-price contract for the development of instrumentation for the Joint Strike Fighter ( **JSF** ) program. Costs and estimated losses to date on this contract as of July 28, 2006 and January 31, 2006 are as follows:

	<b>July 28, 2006</b>	<b>January 31, 2006</b>
Costs incurred to date	\$ 17,089,000	\$ 16,059,000
Estimated losses	(2,522,000)	(2,030,000)
	14,567,000	14,029,000
Less billings to date	(14,618,000)	(13,609,000)
Costs less estimated losses in excess of billings		\$ 420,000
Billings in excess of costs less estimated losses	\$ (51,000)	

During the quarter ended July 28, 2006, the Company continued working toward completion of all activities related to compliance with safety of flight standards for its JSF air data probe. Delays in progress toward satisfying these requirements were encountered throughout the testing phase, causing the Company to recognize an additional loss of approximately \$228,000 during the quarter ended July 28, 2006.

The JSF program is a customer-funded product development program that is presently expected to generate total project revenues of approximately \$16,281,000. As of July 28, 2006, based on project progress, the Company has recognized revenues of approximately \$14,567,000 for the JSF project. The estimate for this program changes with each technological breakthrough and setback and the Company will continue to adjust its estimate to reflect the most current view of the program's costs. The revenues and costs recorded in each quarter reflect the Company's best estimate of the program's expected profitability or loss at that point in time. Billings in excess of costs less estimated losses of approximately \$51,000 at July 28, 2006 are included in accrued expenses and other liabilities in the accompanying condensed consolidated balance sheet.

**Note 5 Accrued Expenses and Other Liabilities**

Accrued expenses and other liabilities as of July 28, 2006 and January 31, 2006 were approximately \$1,775,000 and \$1,895,000, respectively. A substantial portion of these expenses are related to amounts owed to subcontractors who participate in the Company's product development programs, as shown below:

	<b>July 28, 2006</b>	<b>January 31, 2006</b>
Product development programs	\$ 1,163,000	\$ 1,389,000
Other accrued expenses	612,000	506,000

\$ 1,775,000      \$ 1,895,000

### Note 6 Long Term Debt and Notes Payable

The Company's credit facilities are with Wachovia Bank, N.A. ( **Wachovia** ). The facilities total approximately \$5.7 million, and include a 15 year term loan of approximately \$3.0 million that is collateralized by the Company's real estate in Clearwater, Florida, a revolving credit facility of approximately \$2.5 million, and a seven year equipment loan of approximately \$0.2 million. All of the Company's other assets (i.e., other than the Clearwater real estate) are subject to liens collateralizing all three of the loans from Wachovia. This includes all assets of Avionics Specialties, Inc., the Company's wholly owned subsidiary.

Long term debt and notes payable at July 28, 2006 and January 31, 2006 consisted of the following:

	July 28, 2006	January 31, 2006
		\$
Mortgage note payable - Wachovia	\$ 2,533,000	2,633,000
Equipment term loan	146,000	161,000
	2,679,000	2,794,000
Less current maturities	(230,000)	(230,000)
Long-term debt and notes payable, less current maturities	\$ 2,449,000	\$ 2,564,000

## Covenants

The Company's long-term debt agreements with Wachovia contain certain financial and other restrictive covenants, including the requirement to maintain: (i) at all times, a ratio of total liabilities to tangible net worth that does not exceed 1.30 to 1.00; and (ii) at the end of each fiscal quarter, a cash flow coverage ratio (with regard to the debt service) of at least 1.25 to 1.00. As of July 28, 2006, the Company was in compliance with these financial covenants.

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

The Company's ability to maintain sufficient liquidity and compliance with these covenants in fiscal year 2007 and beyond is highly dependent upon achieving expected operating results. Failure to achieve expected operating results and compliance with covenants could have a material adverse effect on the Company's liquidity and operations in fiscal year 2007 and beyond, and could require implementation of further measures, including deferring planned capital expenditures, reducing discretionary spending, and/or, if necessary, selling assets.

## Note 7 Accounting for Stock-Based Compensation

Effective February 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123R, Accounting for Stock-Based Compensation (SFAS 123R), which requires stock-based compensation to be measured on the fair value of the awards on the grant date. The Company elected a modified prospective method of transition as permitted by SFAS 123R. Under this transition method, the Company is required to record compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that were outstanding at the date of adoption, and accordingly, periods prior to the adoption are not restated. For the three- and six-month periods ended July 28, 2006, total equity-based compensation of approximately of \$8,600 and \$17,200, respectively, related to stock options previously granted was included in operating expense.

## Note 8 Earnings per Share

Basic earnings per share are based upon the Company's weighted average number of common shares outstanding during each period. Diluted earnings per share are based upon the weighted average number of common shares outstanding during each period, assuming the issuance of common shares for all dilutive potential common shares outstanding during the period, using the treasury stock method.

	Three Months Ended		Six Months Ended	
	July 28, 2006	July 29, 2005	July 28, 2006	July 29, 2005
Weighted average shares outstanding basic	3,562,739	3,921,019	3,656,933	3,921,019
Dilutive effect of stock options	-	-	13,428	-



Weighted average shares outstanding diluted	3,562,739	3,921,019	3,670,361	3,921,019
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In accordance with generally accepted accounting principles, the dilutive effect of options on 32,500 shares of our common stock was not included in the calculation of diluted loss per share for the three months ended July 28, 2006 as their effect would be antidilutive. In addition, there was no dilutive effect for the three and six months ended July 29, 2005 as there were no vested stock options outstanding during that period.

Note 9 Commitments, Contingencies and Subsequent Events

The Company accrues for environmental expenses resulting from existing conditions that relate to past operations when the costs are probable and reasonably estimable. The following table outlines the Company's accrual that existed at the close of each fiscal period:

	<b>July 28, 2006</b>	<b>January 31, 2006</b>
Environmental Accrual	\$ 73,000	\$ 80,000

The environmental accrual is included in accrued expenses and other liabilities in the accompanying condensed consolidated balance sheets.

The Company's revolving credit facility with Wachovia, which was set to expire June 30, 2006, was renewed effective May 24, 2006. The limit of this facility remains at \$2.5 million. The expiration date is June 30, 2007.

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### **ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS ( MD&A )**

#### **Results of Operations**

Revenues for the second quarter of 2007 decreased approximately \$1,382,000 when compared to the second quarter of 2006. Core instrument and spare parts sales decreased by approximately \$1,596,000 when compared to the second quarter of 2006. The decrease in core instrument sales was driven primarily by lower integrated multifunction probe ( IMFP ) and angle of attack ( AOA ) transmitter sales. This reduction was partially offset by an increase in repair revenue of approximately \$228,000. Revenue from the Joint Strike Fighter ( JSF ) development program decreased by approximately \$14,000 as the Company's development program nears completion.

Revenues for the six months ended July 28, 2006 decreased approximately \$1,976,000 when compared to the six months ended July 29, 2005. Core instrument and spare parts sales decreased by approximately \$1,946,000 when compared to the six months ended July 29, 2005. The decrease in core instrument sales was driven primarily by lower IMFP, AOA transmitter and altimeter sales. This reduction was partially offset by an increase in repair revenue of approximately \$440,000. JSF program revenue decreased by approximately \$470,000 during the period, as the Company's development program nears completion.

Gross profit for the second quarter of 2007 decreased by approximately 37%, or approximately \$1,112,000, when compared to the second quarter of 2006. This decrease was driven primarily by a reduction in volume that resulted in lower absorption of labor and overhead costs as well as higher material costs.

Gross profit for the six months ended July 28, 2006 decreased by approximately 16%, or approximately \$895,000, when compared to the six months ended July 29, 2005. The reduction in sales volume resulted in lower absorption of labor and overhead costs and more than offset the gross profit improvements that were realized in the first quarter of fiscal year 2007 as a result of a favorable shift in the Company's sales mix.

Selling, general and administrative expenses for the second quarter of 2007 decreased approximately \$207,000 when compared to the second quarter of 2006. This decrease was attributable to lower outside engineering costs in the Clearwater operations as well as a reduction in legal fees and expenses.

Selling, general and administrative expenses for the six months ended July 28, 2006 increased approximately \$111,000 when compared to the six months ended July 29, 2005. This increase was attributable to increased costs for compensation and benefits, travel and entertainment and corporate governance expenses. The increase in travel and entertainment was due primarily to an increase in international business activity.

Net interest expense increased approximately \$13,000 for the second quarter of 2007 when compared to the second quarter of 2006. This increase resulted from payments on debt obligations in the current period, while such payments were partially offset by the one-time receipt of interest payments of approximately \$15,000 in conjunction with the Company's receipt of income tax refunds during the first quarter of 2006.

Net interest expense decreased approximately \$1,000 for the six months ended July 28, 2006 when compared to the six months ended July 29, 2005. This decrease resulted from a reduction in outstanding debt obligations.

Miscellaneous income increased approximately \$25,000 for the second quarter of 2007 when compared to the second quarter of 2006. This increase was due to a reduction in foreign currency expense.

Miscellaneous income increased approximately \$6,000 for the first six months of 2007 when compared to the same period of 2006. This increase was due to the recognition of a gain on the sale of fixed assets of approximately \$33,000 in the first quarter of 2007 and was partially offset by charges resulting from the settlement of foreign currency-denominated obligations.

Income tax expense decreased approximately \$334,000 for the second quarter of 2007 when compared to the second quarter of 2006, resulting in an income tax benefit for the current period. This decrease was due to lower earnings and a reduction in the anticipated effective tax rate for the current period when compared to the effective tax rate that was employed in the prior reporting period.

Income tax expense decreased approximately \$574,000 for the six months ended July 28, 2006 when compared to the six months ended July 29, 2005. This decrease was due to lower earnings as well as a reduction in the anticipated effective tax rate for the current period when compared to the effective tax rate that was employed in the prior reporting period.

The reduction in the anticipated effective tax rate was due to the expected utilization of tax loss carryforwards in the current year that are expected to offset the majority of the Company's taxable income for the fiscal year ending January 31, 2007.

### **Liquidity and Capital Resources**

Cash provided by operating activities was approximately \$844,000 for the second quarter of 2007, a decrease in cash provided of approximately \$1,402,000 when compared to the second quarter of 2006. This decrease in cash provided is primarily attributable to:

A decrease in net income of approximately \$425,000

A decrease due to accounts payable of approximately \$1,368,000 as the Company maintained a substantial majority of accounts at a current status. In addition, the Company had withheld a vendor payment of approximately \$685,000 during the second quarter of 2006 pending the resolution of a dispute that has since been resolved

A decrease due to net income taxes receivable and payable of approximately \$864,000 due to a reduced level of income tax refunds available

A decrease due to an increase in costs less estimated losses in excess of billings of approximately \$790,000 resulting from continuing progress on the JSF program and the achievement of project milestones for which invoices have been issued

A decrease due to accrued expenses and other liabilities of approximately \$92,000 due primarily to further reductions in liabilities to suppliers for the JSF contract

These increases in cash usage were partially offset by the following increases in cash provided:

An increase due to compensation and benefits liabilities of approximately \$74,000

An increase due to accounts receivable of approximately \$1,385,000 resulting from improvements in collections as well as a decrease in sales volume

An increase of approximately \$498,000 due to a reduction in inventory

An increase due to the gain on the sale of assets of approximately \$41,000

An increase due to a reduction in other assets of approximately \$14,000 as the Company secured the return of deposits from professional service providers.

An increase due to prepaid expenses of approximately \$182,000 as all insurance premiums for the six months ended July 28, 2006 were paid with cash whereas some insurance premiums for the six months ended July 29, 2005 were paid utilizing premium financing

Cash used in investing activities decreased approximately \$48,000 in the first six months of fiscal year 2007 as compared to the same period in fiscal year 2006 due to lower investment in Machinery and Equipment.

Cash used in financing activities increased approximately \$2,454,000 for the first six months of fiscal year 2007 when compared to the six months ended July 29, 2005 as the Company repurchased approximately 9.31% of its outstanding common stock during the period, resulting in a cash outflow of approximately \$2,467,000. This outflow was partially offset by a reduction in the scheduled repayment of long-term debt obligations of approximately \$13,000.

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

The Company's ability to maintain sufficient liquidity in fiscal year 2007 and beyond is highly dependent upon achieving expected operating results. Failure to successfully achieve these results could have a material adverse effect on the Company's liquidity and operations in fiscal year 2007, and could require implementation of curative measures, including deferring planned capital expenditures, reducing discretionary spending, and/or, if necessary, selling assets.

### ***Critical Accounting Policies***

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

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

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

### ***Revenue Recognition***

The Company manufactures most of its products on a build-to-order basis and ships products upon completion. The Company has a policy of strict adherence to the provisions of SEC Staff Accounting Bulletin 104 ( **SAB 104** ) in order to accurately state its revenues in each accounting period. For certain situations, some judgment is required, but most sales have clear revenue recognition criteria.

Revenue sources for product sales are largely from sales to commercial and government customers. The majority of customer sales terms are F.O.B. origin, although some customer terms are F.O.B. destination. For those customers where terms are origin , revenue is generally recognized upon shipment, unless additional prevailing factors would not be in accordance with the revenue recognition requirements of SAB 104. For those customers whose terms are destination , revenue is generally not recognized until goods arrive at the customers premises and all other revenue recognition criteria are met.



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

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

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

#### ***Accounts Receivable Allowance for Doubtful Accounts and Credit Losses***

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

#### ***Provisions for Excess and Obsolete Inventory Losses and Residual Value Losses***

The Company values inventory at the lower of cost (using a method that approximates the first-in, first-out method) or net realizable value. Reviews of inventory quantities on hand have been conducted to determine if usage or sales history supports maintaining inventory values at full cost or if it has instead become necessary to record a provision

for slow moving, excess and obsolete inventory based primarily on estimated forecasts of product demand and production requirements for the subsequent twelve months. Estimates of future product demand may prove to be inaccurate, in which case the Company may understate or overstate the provision required for excess and obsolete inventory. Although the Company endeavors to ensure the accuracy of forecasts of future product demand, any significant unanticipated changes in demand or technological developments could have a significant impact on the value of inventory and consequently reported operating results.

***Work In Process Inventories***

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

***Manufacturing Overhead Cost Application***

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

***Deferred Tax Asset Valuation Allowance***

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

***Long-Lived Assets***

Management periodically evaluates long-lived assets for potential impairment and will record an impairment charge whenever events or changes in circumstances indicate the carrying amount of the assets may not be fully recoverable. As of July 28, 2006 and January 31, 2006, management does not believe that any long-lived assets are impaired.

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

***Other Accounts Affected by Management Estimates***

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

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

Management also uses estimates in calculating the percentage of completion of the JSF program. These estimates have a significant impact on Costs less estimated losses in excess of billings included in the Company's consolidated balance sheets.

#### ***Off-Balance Sheet Arrangements***

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

#### ***Contractual Obligations***

There have been no material changes to our commitments and contingencies from that disclosed in our Annual Report on Form 10-K for the fiscal year ended January 31, 2006.

**ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

The primary market risk exposure for the Company is interest rate risk. The Company's existing debt facilities require the payment of interest at a variable rate equal to one-month LIBOR plus 300 basis points. Consequently, the Company has an exposure to fluctuations in the underlying interest rate for its debt facilities. As an example, the prevailing rate for one-month LIBOR at July 28, 2006 was approximately 5.40%. Therefore, the Company's borrowing cost under its existing debt facilities as of July 28, 2006 was 8.40%. For each \$1.0 million of borrowing at the July 28, 2006 one-month LIBOR interest rate, the Company's annual interest cost would be \$84,000. Significant fluctuations in the underlying LIBOR interest rate index could have a material impact on the Company's financial statements. Presently, the Company does not utilize any financial instruments to manage this interest rate risk.

The Company also has a market risk exposure to fluctuations in foreign exchange rates. The Company has a limited number of purchase and sale transactions that are denominated in British Pounds. The Company's strategy in managing this risk exposure is to match the timing of British Pound-denominated cash inflows and outflows. British Pound-denominated cash inflows generally exceed outflows, and the excess balance, if nominal, is maintained in a British Pound-denominated bank account. Substantial amounts of foreign currency are otherwise immediately converted to U.S. Dollars when received.

**ITEM 4 CONTROLS AND PROCEDURES.**

As of July 28, 2006, Aerosonic's Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of Aerosonic's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) and concluded that such disclosure controls and procedures were effective as of such date.

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**PART II OTHER INFORMATION**

**ITEM 1 LEGAL PROCEEDINGS**

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

**ITEM 1A RISK FACTORS**

The risk factors included in our Annual Report on Form 10-K for the fiscal year ended January 31, 2006 have not materially changed.

**ITEM 2 UNREGISTERED SALE OF EQUITY SECURITIES AND USE OF PROCEEDS**

None

**ITEM 3 DEFAULTS UPON SENIOR SECURITIES**

None

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

The Annual Meeting of Stockholders of the Company was held on July 10, 2006 (the Annual Meeting). At the Annual Meeting the only matter considered by stockholders was the election of two directors of the Company for three-year terms. Stockholders elected the following two nominees as directors to serve until the annual meeting following the 2009 meeting of the Company's stockholders and until their respective successors are duly elected and qualified. The following table sets forth the individuals nominated for election, as well as the results.

<u>Nominee</u>	<u>For</u>	<u>Withheld</u>	
Robert J. McGill	2,989,468 shares	146,182	shares
P. Mark Perkins	2,995,203 shares	140,447	shares

The following directors, whose terms did not expire at the Annual Meeting, continued to serve as directors of the board of directors of the Company following the Annual Meeting: David A. Baldini, Thomas E. Whytas and Donald Russell.

## ITEM 5 OTHER INFORMATION

None

## ITEM 6 EXHIBITS

<u>Exhibit No.</u>	<u>Description of Exhibit</u>
31.1	Section 302 Certifications
31.2	Section 302 Certifications
32.1	Section 906 Certifications
32.2	Section 906 Certifications

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: September 11, 2006

**AEROSONIC CORPORATION**

/s/ David A. Baldini

David A. Baldini

Chairman, President and Chief Executive Officer

Date: September 11, 2006

**AEROSONIC CORPORATION**

/s/ Gary E. Colbert

Gary E. Colbert

Executive Vice President and Chief Financial Officer



**CERTIFICATIONS**

I, David A. Baldini, certify that:

1. I have reviewed this Quarterly report on Form 10-Q of Aerosonic Corporation;
  
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
  
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
  
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  
  - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  
  - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
  
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: September 11, 2006

/s/ David A. Baldini

David A. Baldini

Chairman, President and Chief Executive Officer

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## CERTIFICATIONS

I, Gary E. Colbert, certify that:

1. I have reviewed this Quarterly report on Form 10-Q of Aerosonic Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: September 11, 2006

/s/ Gary E. Colbert

Gary E. Colbert

Executive Vice President and Chief Financial Officer

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**AEROSONIC CORPORATION**

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Aerosonic Corporation (the **registrant** ) on Form 10-Q for the period ended July 28, 2006 as filed with the Securities and Exchange Commission on the date hereof (the **report** ), I, David A. Baldini, Chief Executive Officer of the registrant, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

- (1) The report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934: and
  
- (2) The information contained in the report fairly presents, in all material respects, the financial condition and result of operations of the registrant.

Date: September 11, 2006

/s/ David A. Baldini

David A. Baldini

Chairman, President and Chief Executive Officer

**AEROSONIC CORPORATION**

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Aerosonic Corporation (the **registrant** ) on Form 10-Q for the period ended July 28, 2006 as filed with the Securities and Exchange Commission on the date hereof (the **report** ), I, Gary E. Colbert, Chief Financial Officer of the registrant, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

- (1) The report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934: and
  
- (2) The information contained in the report fairly presents, in all material respects, the financial condition and result of operations of the registrant.

Date: September 11, 2006

/s/ Gary E. Colbert

Gary E. Colbert

Executive Vice President and Chief Financial Officer