AMERICAN SCIENCE & ENGINEERING INC
Form 10-Q
August 09, 2005

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2005

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

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes ý No o

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date

Class of Common Stock

	Outstanding at July, 27, 2005
$.66 2/3 par value	8,417,548

American Science and Engineering, Inc. and Subsidiary

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PART I FINANCIAL INFORMATION

Item 1 Financial Statements

American Science and Engineering, Inc. and Subsidiary

Condensed Consolidated Balance Sheets

Dollars in thousands

	June 30, 2005 (unaudited)	March 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 22,960	$ 15,418
Restricted cash and investments	982	355
Short-term investments	22,393	20,590
Accounts receivable, net of allowances of $431 and $501 at June 30, 2005 and March 31, 2005, respectively	23,022	28,170
Unbilled costs and fees, net of allowances of $76 at June 30, 2005 and March 31, 2005	1,148	691
Note receivable	2,800	2,800
Inventories	21,942	24,941
Deferred tax assets	2,154	
Prepaid expenses and other current assets	2,299	1,957
Total current assets	99,700	94,922
Equipment and leasehold improvements, net	4,109	3,329
Deferred tax asset	3,450	
Other assets, net		36
Total assets	$ 107,259	$ 98,287
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 2,831	$ 6,743
Accrued salaries and benefits	1,546	3,158
Accrued warranty costs	2,768	2,322
Accrued income taxes	285	15
Deferred revenue	2,942	3,634
Customer deposits	7,947	11,132
Other current liabilities	5,188	2,986
Total current liabilities	23,507	29,990
Warrant liability	4,906	6,137
Other non-current liabilities	671	590
Total liabilities	29,084	36,717
Stockholders equity:		
Preferred stock, no par value Authorized 100,000 shares; Issued none		
	5,607	5,560

Common stock, $0.66 2/3 par value Authorized 20,000,000 shares Issued and Outstanding 8,412,290 shares at June 30, 2005 and 8,341,480 shares at March 31, 2005				
Capital in excess of par value		63,628		54,098
Accumulated other comprehensive income		(19)		(12)
Unearned compensation		(131)		(169)
Retained earnings		9,090		2,093
Total stockholders equity		78,175		61,570
Total liabilities and stockholders equity	$	107,259	$	98,287

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

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American Science and Engineering, Inc. and Subsidiary

Condensed Consolidated Statements of Operations

(Unaudited)

Dollars and shares in thousands, except per share amounts

		For the Three Months Ended	
		June 30, 2005	**June 30, 2004**
Net sales and contract revenues:			
Net product sales and contract revenues		$ 29,513	$ 12,822
Net service revenues		5,649	3,990
Total net revenues and contract revenues		35,162	16,812
Cost of sales and contracts:			
Cost of product sales and contracts		17,027	9,522
Cost of service revenues		3,543	2,152
Total cost of sales and contracts		20,570	11,674
Gross profit		14,592	5,138
Expenses:			
Selling, general and administrative		4,138	3,274
Research and development		2,422	1,455
Total expenses		6,560	4,729
Operating income		8,032	409
Other income (expense):			
Interest and investment income		361	41
Other, net		14	(71)
Change in warrant valuation		533	(920)
Total other income (expense)		908	(950)
Income (loss) before provision for income taxes		8,940	(541)
Provision for income taxes		1,943	
Net income (loss)		$ 6,997	$ (541)
Income (loss) per share	Basic	$ 0.84	$ (0.07)
	Diluted	$ 0.78	$ (0.07)
Weighted average shares	Basic	8,376	7,558
	Diluted	8,984	7,558

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

American Science and Engineering, Inc. and Subsidiary

Condensed Consolidated Statements of Cash Flows

(Unaudited)

Dollars in thousands

	For the Three Months Ended June 30, 2005	June 30, 2004
Cash flows from operating activities:		
Net income (loss)	$ 6,997	$ (541)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	201	338
Provisions for inventory and accounts receivable reserves	1,126	140
Realized gain on short-term investments		(2)
Amortization of bond discount	(109)	
Deferred income taxes	(1,167)	
Reduction of income taxes paid due to the tax benefit from employee stock option expense	251	
Reversal of deferred tax asset valuation allowance	2,588	
Change in value of warrants	(534)	920
Stock compensation expense	52	38
Changes in assets and liabilities:		
Accounts receivable	5,216	2,625
Unbilled costs and fees	(457)	60
Inventories	1,805	(1,294)
Prepaid expenses and other assets	(306)	(35)
Accounts payable	(3,912)	528
Accrued income taxes	270	15
Customer deposits	(3,185)	(527)
Deferred revenue	(691)	(394)
Other current liabilities	1,152	(18)
Non-current liabilities	80	(21)
Net cash provided by operating activities	9,377	1,832
Cash flows from investing activities:		
Purchases of short-term investments	(13,020)	
Maturities of short-term investments	11,330	926
Purchases of property and equipment	(981)	(678)
Net cash provided by (used for) investing activities	(2,671)	248
Cash flows from financing activities:		
Increase in restricted cash and investments	(627)	(44)
Proceeds from exercise of warrants	838	
Proceeds from exercise of stock options	636	4,006
Net cash provided by financing activities	847	3,962
Foreign currency translation effect on cash	(11)	(10)
Net increase in cash and cash equivalents	7,542	6,032
Cash and cash equivalents at beginning of period	15,418	18,232
Cash and cash equivalents at end of period	$ 22,960	$ 24,264

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

American Science and Engineering, Inc. and Subsidiary

Notes to Unaudited Condensed Consolidated Financial Statements

1. General

The condensed consolidated financial statements include the accounts of the Company and its wholly owned Subsidiary. 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 condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company s Annual Report on Form 10-K for the year ended March 31, 2005.

The consolidated financial statements, in the opinion of management, include all adjustments necessary, 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 is engaged in the development and manufacture of sophisticated X-ray inspection systems for critical detection and security screening solutions for sale primarily to U.S. and foreign government agencies. The Company has only one reporting segment, X-ray screening products.

Significant Accounting Policies

Revenues on cost reimbursable and long-term fixed price contracts are generally recorded as costs are incurred using the percentage of completion method. For systems that are produced in a standard manufacturing operation and have shorter order to delivery cycles, the Company recognizes sales at the time of shipment of the system to the customer and when other revenue recognition criteria are met.

The Company s Export and Security Agreement with Silicon Valley Bank East requires certain cash balances to be restricted as collateral against outstanding standby letters of credit. (see Note 4)

The significant accounting policies followed by the Company and its Subsidiary 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, 2005.

Certain amounts in the prior period financial statements have been reclassified to conform to the current period presentation.

Comprehensive Income

Comprehensive income is comprised of the following:

	Three months ended			
(in thousands)	**June 30, 2005**		**June 30, 2004**	
Net income (loss)	$	6,997	$	(541)
Foreign currency translation adjustments		(11)		(10)
Unrealized gains and losses from marketable securities		4		
Comprehensive income (loss)	$	6,990	$	(551)

Pro Forma Stock-Based Compensation Expense

As permitted by SFAS No. 123, Accounting for Stock-Based Compensation, the Company has elected to continue to apply Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, to account for its stock-based compensation plans. Had compensation cost for awards under the Company s stock-based compensation plans been determined based on the fair value at the grant dates consistent with the method set forth under SFAS No. 123, the effect on the Company s net income (loss) and income (loss) per share would have been as follows:

(in thousands except per share data)	Three months ended June 30, 2005		Three months ended June 30, 2004	
Net income (loss):				
As reported	$	6,997	$	(541)
Add: Stock based compensation included in net income as reported		52		38
Less: Stock based compensation using fair value method for all awards		(3,976)		(150)
Pro forma net income (loss)	$	3,073	$	(653)
Income (loss) per share Basic:				
As reported	$	0.84	$	(0.07)
Pro forma	$	0.37	$	(0.09)
Income (loss) per share Diluted:				
As reported	$	0.78	$	(0.07)
Pro forma	$	0.34	$	(0.09)

On April 22, 2005, the Company announced that its Board of Directors had accelerated the vesting of certain unvested stock options previously awarded to employees. Options to purchase 186,033 shares of common stock were subject to the acceleration. The acceleration was effective immediately, on a fully-vested basis. Options held by the Board of Directors, Chief Executive Officer, the Chief Financial Officer, and other employees who participated in other incentive or commission compensation plans were excluded from the acceleration. The Company recorded during the quarter ended June 30, 2005 $14,000 in compensation expense related to these accelerated options.

The fair value of each option granted was estimated on the grant date using the Black-Scholes option pricing model with the following weighted average assumptions: risk-free interest rate of 3.7% for fiscal 2006, 3.8% was used for fiscal 2005, and 5% for fiscal 2004, expected volatility of 72%, 73%, 72% and 73% was used for fiscal 2006, 2005, and 2004, respectively, an expected dividend yield of 0% and an expected life of 3 years in fiscal 2006, 5 years in fiscal 2005 and 7 years for fiscal year 2004.

2. Inventories

Inventories consisted of:

(in thousands)	June 30, 2005		March 31, 2005	
Raw materials and completed sub-assemblies	$	8,002	$	12,763
Work-in-process		8,768		5,458
Finished goods		5,172		6,720
Total	$	21,942	$	24,941

3. Income 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. Diluted earnings (loss) per share include the dilutive impact of options and warrants using the average share price of the Company s common stock for the period. For the quarters ended June 30, 2005 and June 30, 2004, common stock equivalents of 96,626 and 792,633, respectively, are excluded from diluted earnings per share, as their effect is anti-dilutive.

(in thousands except per share amounts)	Three Months Ended June 30, 2005	Three Months Ended June 30, 2004
Basic earnings per share		
Net income (loss)	$ 6,997	$ (541)
Weighted average number of common shares outstanding basic	8,376	7,558
Net income (loss) per share basic	$ 0.84	$ (0.07)
Diluted earnings per share		
Net income (loss)	$ 6,997	$ (541)
Weighted average number of common shares outstanding basic	8,376	7,558
Assumed exercise of stock options and warrants, using the treasury stock method	608	
Weighted average number of common and potential common shares outstanding diluted	8,984	7,558
Net income (loss) per share diluted	$ 0.78	$ (0.07)

4. Borrowings

On November 30, 2004, the Company modified its two credit agreements with Silicon Valley Bank East. The modifications extended the credit facilities which expired on November 30, 2004 through November 29, 2006 and reduced the export loan and security facility, guaranteed by the Export-Import Bank of the United States, from $20.0 million to $10.0 million. The domestic facility is a $5.0 million domestic loan and security agreement to support the Company s routine working capital needs. Maximum borrowings for this facility are set at the lower of (a) the sum of 80% of eligible domestic accounts receivable plus 10% of finished goods inventory up to $750,000, or (b) $5 million.

The credit facilities bear an interest rate of the greater of 4.0% or the Silicon Valley Bank prime rate (6.0% at June 30, 2005). The credit agreements are collateralized by certain assets of the Company and contain certain restrictions, including limitations on the amount of distributions that can be made to stockholders, and the disposition or encumbrances of assets, and require the maintenance of certain financial covenants.

At June 30, 2005, there were no borrowings outstanding against these credit facilities. The Company had outstanding $300,000 in stand-by letters of credit against the domestic facility related to its building lease and $58,000 in stand-by letters of credit against the export facility guaranteeing performance on an international project. No amounts have been drawn against these letters of credit. In addition, at June 30, 2005, the Company had a restricted cash balance of $982,000 related to certain bank required deposits related to outstanding letters of credits, bid bonds, and other bank-related fees.

5. Warrant Liability

On May 28, 2002, the Company closed on a private placement offering of common stock and warrants. A total of 1,115,000 shares were sold to accredited investors at a price of $17.64 per share. In addition, warrants to purchase an additional 295,475 shares of common stock at an exercise price of $23.52 per share were issued. The warrants were immediately vested and have a five-year life expiring in May of 2007.

During the quarter ended June 30, 2005, warrants to purchase 35,625 shares of common stock were exercised resulting in total proceeds received of $838,000. The fair market value of the warrants at the date of exercise totaled $698,000. The cash proceeds and the fair value of the liability were recorded as additional paid in capital at June 30, 2005.

At June 30, 2005, 185,750 warrants remain outstanding. Due to certain conversion features of these warrants that provide that the holder may opt for a cash settlement in certain instances, including a merger, a sale of all or substantially all of the Company s assets, or a tender offer or exchange offer of shares of the Company s stock, a liability equal to the Black-Scholes valuation of the warrants at the deal closing date was recorded on the Company s balance sheet. The mark to market change in the warrants valuation of $533,000 and ($920,000) was recorded as other income (expense) for the quarters ended June 30, 2005 and June 30, 2004, respectively. The liability of $4,906,000 and $6,137,000 representing the fair market value of outstanding warrants at period end is recorded as a non-current liability at June 30, 2005 and March 31, 2005, respectively. The fair market value of the warrants was determined using the Black-Scholes pricing model with an assumed volatility of 72% and 73% at June 30, 2005 and March 31, 2005, respectively, an interest rate of 3.3% and 3.25% at June 30, 2005 and March 31, 2005, respectively and a life equal to the remaining term of the warrants at each period end.

6. Income Taxes

At March 31, 2005, the Company had gross deferred tax assets of $9,740,000. The Company had applied a full valuation allowance against its deferred tax assets at March 31, 2005 based upon its evaluation of three year cumulative historical results and its projection of future taxable income and had determined that it was more likely than not that its deferred tax asset would not be realized.

In the first quarter of fiscal 2006, the Company has reevaluated its valuation allowance for deferred tax assets and has determined that a full release of valuation allowances is appropriate based upon current period earnings, the Company s updated forecasted earnings for fiscal 2006, sales backlog and other factors. The release of the valuation allowance has been included in determining the Company s annual effective tax rate for fiscal 2006. In connection with this release, the Company recorded a corresponding entry to paid in capital totaling $7,025,000 for net operating loss carryforwards resulting from the exercise of certain employee stock options.

7. Guarantees

Certain of the Company s parcel and cargo products carry a one-year warranty, the costs of which are accrued for at time of shipment or delivery. Accrual rates are based upon historical experience over the preceding twelve months and management s judgment of future exposure. Warranty experience for the three months ended June 30, 2005 and June 30, 2004 is as follows:

(in thousands)		Three months ended June 30, 2005		Three months ended June 30, 2004
Warranty accrual at beginning of period	$	2,322	$	699
Accruals for warranties issued during the period		814		406
Warranty costs incurred during period		(368)		(205)
Warranty accrual at end of period	$	2,768	$	900

In conjunction with the sale of certain assets and contracts of the Company s High Energy Systems Division in January of 2005, the lease for the California operations of the High Energy Systems Division was assigned to Accuray. The Company remains secondarily liable for the remaining lease payments in the event of default by Accuray during the lease term which expires in February 2011. Total remaining lease payments at June 30, 2005 totaled $2,011,000. No accrual for this contingent liability has been recorded at June 30, 2005 as payment of this liability is considered remote.

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

Results of Operations

Net revenues for the first quarter of fiscal 2006 increased by $18,350,000 to $35,162,000 compared to the corresponding period a year ago. This increase is attributable primarily to an increase of $16,691,000 in product sales due to increased shipments of Z Backscatter systems which experienced high order volume in the latter half of fiscal 2005. In addition, there was an increase in CargoSearch system revenues with increased activity on two system projects ongoing during the quarter. ParcelSearch system revenues remained relatively flat from the prior year. These increases were offset somewhat by a $1,574,000 decrease in sales from the High Energy Systems group due to the sale of certain assets and contracts of the High Energy Systems division in the fourth quarter of fiscal 2005. Service revenues increased by $1,659,000 to $5,649,000 compared to the first quarter of fiscal 2005 due primarily to the increased volume of service contracts related to systems sold over the past 12 months.

Total cost of sales and contracts for the first quarter of fiscal 2006 increased by $8,896,000 to $20,570,000 as compared to the corresponding period a year ago. Cost of product sales and contracts increased by $7,505,000 to $17,027,000 as compared to the corresponding period a year ago. Cost of product sales and contract revenues represented 58% of revenues versus 74% of revenue for the corresponding period last year. This improvement in gross margin is due primarily to improved absorption of fixed overhead costs due to the significant volume increases, and the reduction of direct costs of certain products through improved supplier agreements and a reduction of internal labor costs per system due to operating efficiencies. Some of the product gross margin improvement was offset by an increase in reserves for excess and obsolete inventory ($1,100,000) in the quarter due to changes in the Company s projected mix of product usage. Cost of services revenues increased by $1,391,000 to $3,543,000 as compared to the corresponding period a year ago. Cost of service revenues represented 63% of revenues versus 54% for the corresponding period last year. This margin decline is due primarily to comparatively higher costs incurred on certain service contracts during the period.

Selling, general and administrative expenses for the first quarter of fiscal 2006 of $4,138,000 were $864,000 higher than the corresponding period a year ago. Selling, general and administrative expenses represented 12% of revenues in the current period as compared to 19% for the corresponding period last year. The increase in costs are attributable primarily to increased incentive and payroll costs for sales and marketing ($397,000), marketing related costs ($221,000) due to increased headcount and sales activity, increased legal expenditures ($204,000) related to outstanding litigation, and costs related to the Company s software implementation project ($126,000). These increases were offset by $290,000 related to the High Energy Systems division whose assets were sold in the fourth quarter of fiscal 2005 and remaining operations consolidated with the Company s corporate headquarters.

Company funded research and development expenses of $2,422,000 for the first quarter of fiscal 2006 increased by $967,000 compared to the corresponding period last year. Research and development expenses represented 7% of revenues in the current period compared to 9% for the corresponding period last year. These expenditures increased primarily due to one major product development program which was started in the latter half of fiscal 2005.

Other income (expense) was $908,000 in income for the first quarter of fiscal 2006 as compared to $950,000 in expense for the corresponding period a year ago. At June 30, 2005, other income (expense) included warrants which were marked to market using Black-Scholes and the change in the valuation of the warrants of $533,000 was recorded as other income in the quarter. During the three months ended June 30, 2004, this mark to market adjustment generated $920,000 in other expense. In addition, in the quarter ended June 30, 2005, the Company earned $341,000 in income on investments held as compared to $41,000 in the quarter ended June 30, 2004.

The Company reported pre-tax income of $8,940,000 in the current quarter as compared to a pre-tax loss of $541,000 in the corresponding period a year ago. At March 31, 2005, the Company had gross deferred tax assets of $9,740,000. The Company had applied a full valuation allowance against its deferred tax assets at March 31, 2005 based upon its evaluation of three year cumulative historical results and its projection of future taxable income and had determined that it was more likely than not that its deferred tax asset would not be realized.

In the first quarter of fiscal 2006, the Company has reevaluated its valuation allowance for deferred tax assets and has determined that a full release of valuation allowances is appropriate based upon current period earnings, the Company s updated forecasted earnings for fiscal 2006, sales backlog and other factors. The release of the valuation allowance has been included in determining the Company s annual effective tax rate for fiscal 2006. In connection with this release, the Company recorded a corresponding entry to paid in capital totaling $7,025,000 for net operating loss carryforwards resulting from the exercise of certain employee stock options.

The Company had net income of $6,997,000 during the first quarter of fiscal 2006 as compared to net loss of $541,000 in the first quarter of fiscal 2005. The significant factors contributing to these results are noted in the above sections.

Liquidity and Capital Resources

Cash and cash equivalents increased by $7,542,000 to $22,960,000 at June 30, 2005 compared to $15,418,000 at March 31, 2005. This increase in cash and cash equivalents is due to cash provided by operations generated primarily from profits earned during the quarter, as well as $1,474,000 received upon exercise of outstanding stock options and warrants. These increases were offset somewhat by net purchases of short term investments of $1,690,000 during the quarter and $981,000 in capital expenditures related primarily to the Company s ongoing ERP system implementation.

On November 30, 2004, the Company modified its two credit agreements with Silicon Valley Bank East. The modifications extended the credit facilities which expired on November 30, 2004 through November 29, 2006 and reduced the export loan and security facility, guaranteed by the Export-Import Bank of the United States, from $20.0 million to $10.0 million. The domestic facility is a $5.0 million domestic loan and security agreement to support the Company s routine working capital needs. Maximum borrowings for this facility are set at the lower of (a) the sum of 80% of eligible domestic accounts receivable plus 10% of finished goods inventory up to $750,000, or (b) $5 million.

The credit facilities bear an interest rate of the greater of 4.0% or the Silicon Valley Bank prime rate (6.0% at June 30, 2005). The credit agreements are collateralized by certain assets of the Company and contain certain restrictions, including limitations on the amount of distributions that can be made to stockholders, and the disposition or encumbrances of assets, and require the maintenance of certain financial covenants.

At June 30, 2005, there were no borrowings outstanding against these credit facilities. The Company had outstanding $300,000 in stand-by letters of credit against the domestic facility related to its building lease and $58,000 in stand-by letters of credit against the export facility guaranteeing performance on an international project. No amounts have been drawn against these letters of credit. In addition, at June 30, 2005, the Company had a restricted cash balance of $982,000 related to certain bank required deposits related to outstanding letters of credits, bid bonds, and other bank-related fees.

New Accounting Pronouncements:

In December 2004, the FASB issued SFAS No. 123(R), Share-Based Payment (SFAS 123(R)) which establishes accounting standards for all transactions in which an entity exchanges its equity instruments for goods and services. SFAS 123(R) revises SFAS No. 123, Accounting for Stock-Based Compensation , supercedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees and amends Financial Accounting Standard No. 95, Statement of Cash Flows . SFAS No. 123(R) generally requires the Company to measure the cost of employee services received in exchange for an award of equity instruments based on the fair value of the award on the date of the grant. The standard requires the fair value on the grant date to be estimated using either an option-pricing model which is consistent with the terms of the award or a market observed price, if such a price exists. The resulting cost must be recognized over the period during which an employee is required to provide service in exchange for the award, which is usually the vesting period. In April 2005, the SEC deferred the effective date for SFAS 123(R) to the beginning of the first fiscal year that begins after June 15, 2005. The Company expects to adopt SFAS 123(R) on the effective date, and expects the adoption to have a material impact on its results of operations, financial position and cash flows.

In December 2004, the FASB issued SFAS No.151, Inventory Costs*,* which amends part of ARB 43, Inventory Pricing, concerning the treatment of certain types of inventory costs. The provisions of ARB No. 43 provided that certain inventory-related costs, such as double freight and re-handling, might be so abnormal that they should be charged against current earnings rather than be included in the cost of inventory. As amended by SFAS No. 151, the so-abnormal criterion has been eliminated. Thus, all such (abnormal) costs are required to be treated as current-period charges under all circumstances. In addition, fixed production overhead should be allocated based on the normal capacity of the production facilities, with unallocated overhead charged to expense when incurred. SFAS 151 is required to be adopted for fiscal years beginning after June 15, 2005. The Company does not believe its adoption will have a material impact on its results of operations, financial position and cash flows.

In December 2004, the FASB issued a FASB Staff Position (FSP) 109-1 Application of FASB 109 to the Tax Deduction on Qualified Production Activities provided by the American Jobs Creation Act of 2004. The new act provides for a special tax deduction on qualified production activities income that effectively reduces the Company s tax rate. The FASB has decided that these amounts should be recorded as a special deduction, and recorded in the year earned. The adoption of this FSP statement will not have an impact on the Company s consolidated financial statements.

Item 3 - Quantitative and Qualitative Disclosures About Market Risk

The cash accounts for the Company s operations in Singapore, Hong Kong, England, and Abu Dhabi are maintained in Singapore dollars, Hong Kong dollars, pounds sterling and dirhams, respectively. Foreign currency accounts are marked to market at current rates that resulted in immaterial translation adjustments to stockholders equity. The gains and losses from foreign currency transactions are included in the statement of operations for the period and were also immaterial. A hypothetical 10% change in foreign currency rates would not have a material impact on the Company s results of operations or financial position.

As of June 30, 2005, the Company held short-term investments consisting of money market funds and U.S. government and government agency bonds. The Company s primary objective with its investment portfolio is to invest available cash while preserving principal and meeting liquidity needs. These investments have an average interest rate of approximately 3.34% and are subject to interest rate risk. As a result of the average maturity and conservative nature of the investment portfolio, a sudden change in interest rates would not have a material adverse effect on the value of these investments.

In fiscal 2003, the Company issued 295,475 warrants in connection with a private placement offering of common stock. As of June 30, 2005, 185,750 of these warrants remain outstanding. These warrants can be exchanged for cash under certain circumstances including a merger, sale or tender offer of the Company, and as such a liability equal to Black-Scholes value of the warrants is recorded on the balance sheet. Changes in the fair value of the warrants are recorded as other income (expense). The Black-Scholes value of these warrants can fluctuate significantly based on the current fair market value of the Company s common stock. A 10% change in the fair market value of the Company s common stock, holding other assumptions constant, would have approximately a $690,000 positive or negative impact on earnings.

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, the Company reviewed and evaluated the effectiveness of the Company s disclosure 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 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 period specified in the Securities and Exchange Commission s rules and forms, and to provide reasonable assurance that information required to be disclosed by the Company in such reports is accumulated and communicated to the Company s management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

b) Changes in internal controls

There have been no changes in our internal controls over financial reporting as such term is defined in Rule 13a-15(f) and 15d-15(f) of the Securities Exchange Act of 1934 during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company s internal controls over financial reporting.

PART II OTHER INFORMATION

Item 1 Legal Proceedings

In February 2004, L-3 Communications, Inc. (L-3) filed a lawsuit against the Company in the United States District Court for the District of Massachusetts in Boston, seeking declaratory judgments of non-infringement and/or invalidity of two of the Company s patents United States Patent No. 6,292,533 and No. 5,903,623. The Company initially filed a motion to dismiss the litigation for lack of subject matter jurisdiction, but was denied. The Company subsequently answered L-3 s underlying complaint, vigorously opposing the plaintiff s non-infringement and invalidity claims, and recently has been engaging in substantial discovery. In December 2004, the Company also filed a motion for summary judgment with respect to one of the principle claims alleged by the plaintiff.

The Company is also subject to various legal proceedings and claims that arise in the ordinary course of business. At the present

time, it is not possible to predict the outcome of these matters, however, the Company currently believes that resolving these matters will not have a material adverse impact on its financial condition, results of operations or cash flows.

Item 6 - Exhibits

(a)	**Exhibits**
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

The information required by Exhibit Item 11 (Statement re: Computation of Income per Common and Common Equivalent Share) may be found in Footnote No. 3 on Page 8.

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 hereunto duly authorized.

AMERICAN SCIENCE AND ENGINEERING, INC.

Date August 9, 2005

/s/ Kenneth J. Galaznik
Kenneth J. Galaznik
Chief Financial Officer and Treasurer

Safe Harbor Statement

The foregoing 10-Q contains statements concerning the Company s financial performance and business operations, which may be considered forward-looking under applicable securities laws.

The Company wishes to caution readers of this Form 10-Q that actual results might differ materially from those projected in any forward-looking statements.

Factors which might cause actual results to differ materially from those projected in the forward-looking statements contained herein include the following: significant reductions or delays in procurements of the Company s systems by the United States and other governments; disruption in the supply of any source component incorporated into AS&E s products; litigation seeking to restrict the use of intellectual property used by the Company; potential product liability claims against the Company; global political trends and events which affect public perception of the threat presented by drugs, explosives and other contraband; global economic developments and the ability of governments and private organizations to fund purchases of the Company s products to address such threats; and the potential insufficiency of Company resources, including human resources, capital, plant and equipment and management systems, to accommodate any future growth and any future delays in federal funding. These and certain other factors which might cause actual results to differ materially from those projected are more fully set forth under the caption Forward-Looking Information and Factors Affecting Future Performance in the Company s Registration Statement on Form 10-K.