

AMERICAN SCIENCE & ENGINEERING, INC.

Form 10-Q

November 09, 2010

[Table of Contents](#)

**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 September 30, 2010

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 1-6549

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 No

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 No

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

Accelerated filer

Non-accelerated filer
(Do not check if a smaller reporting company)

Smaller reporting company

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 No

The number of shares of the registrant's common stock, \$0.66 2/3 par value, outstanding as of November 2, 2010 was 8,986,289.

Table of Contents

TABLE OF CONTENTS

Part I Financial Information

| | |
|---|----|
| <u>Item 1 Financial Statements</u> | 3 |
| <u>Unaudited Condensed Consolidated Balance Sheets September 30, 2010 and March 31, 2010</u> | 3 |
| <u>Unaudited Condensed Consolidated Statements of Operations For the Three and Six Months Ended September 30, 2010 and September 30, 2009</u> | 4 |
| <u>Unaudited Condensed Consolidated Statements of Cash Flows For the Six Months Ended September 30, 2010 and September 30, 2009</u> | 5 |
| <u>Notes to Unaudited Condensed Consolidated Financial Statements</u> | 6 |
| <u>Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 12 |
| <u>Item 3 Quantitative and Qualitative Disclosure About Market Risk</u> | 16 |
| <u>Item 4 Controls and Procedures</u> | 16 |
| <u>Part II Other Information</u> | |
| <u>Item 1A Risk Factors</u> | 16 |
| <u>Item 2 Unregistered Sales of Equity Securities and Use of Proceeds</u> | 17 |
| <u>Item 4 [Removed and Reserved]</u> | 17 |
| <u>Item 6 Exhibits</u> | 17 |
| <u>Signatures</u> | 18 |

Z Backscatter , ZBV , CargoSearch , MobileSearch , Shaped Energy®, AS&E®, ParcelSearch , Gemini , Omniview Gantry, Sentry Portal, SmartCheck® Personnel Screening System, Z Gantry , Z Portal® and all AS&E product names and the AS&E logos are either registered trademarks or trademarks of American Science and Engineering, Inc. in the United States and/or other countries. Other product and company names mentioned herein may be the trademarks of their respective owners.

Table of Contents**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, 2010 | March 31, 2010 |
|--|-------------------------------|---------------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 54,186 | \$ 34,912 |
| Restricted cash | 35 | 35 |
| Short-term investments, at fair value | 114,694 | 144,166 |
| Accounts receivable, net of allowances of \$413 and \$330 at September 30, 2010 and March 31, 2010, respectively | 44,350 | 37,735 |
| Unbilled costs and fees | 15,367 | 2,078 |
| Inventories, net | 52,010 | 45,387 |
| Prepaid expenses and other current assets | 6,734 | 8,998 |
| Deferred income taxes | 1,876 | 2,389 |
| | 289,252 | 275,700 |
| Total current assets | | |
| Building, equipment and leasehold improvements, net | 18,719 | 18,216 |
| Deferred income taxes | 4,529 | 5,171 |
| Other assets, net | 428 | 766 |
| Total assets | \$ 312,928 | \$ 299,853 |
| Liabilities and Stockholders Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 16,796 | \$ 10,970 |
| Accrued salaries and benefits | 9,332 | 13,663 |
| Accrued warranty costs | 705 | 965 |
| Accrued income taxes | 790 | 4,203 |
| Deferred revenue | 16,589 | 14,975 |
| Customer deposits | 11,276 | 13,714 |
| Current portion of lease financing liability | 1,311 | 1,302 |
| Other current liabilities | 6,436 | 3,913 |
| Total current liabilities | 63,235 | 63,705 |
| Lease financing liability, net of current portion | 6,417 | 7,075 |
| Long term deferred revenue | 5,085 | 7,271 |
| Other long term liabilities | 34 | 34 |
| Total liabilities | 74,771 | 78,085 |
| 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; 8,989,498 and 9,013,508 shares issued and outstanding at September 30, 2010 and March 31, 2010, respectively | 5,992 | 6,008 |
| Capital in excess of par value | 98,129 | 97,819 |

Edgar Filing: AMERICAN SCIENCE & ENGINEERING, INC. - Form 10-Q

| | | |
|--|-------------------|-------------------|
| Accumulated other comprehensive income, net | 73 | 33 |
| Retained earnings | 133,963 | 117,908 |
| Total stockholders equity | 238,157 | 221,768 |
| Total liabilities and stockholders equity | \$ 312,928 | \$ 299,853 |

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

Table of Contents

AMERICAN SCIENCE AND ENGINEERING, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

| (In thousands, except per share amounts) | Three Months Ended | | Six Months Ended | |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2010 | September 30, 2009 | September 30, 2010 | September 30, 2009 |
| Net sales and contract revenues: | | | | |
| Net product sales and contract revenues | \$ 59,705 | \$ 42,189 | \$ 92,179 | \$ 76,973 |
| Net service revenues | 20,932 | 19,059 | 42,101 | 38,967 |
| Total net sales and contract revenues | 80,637 | 61,248 | 134,280 | 115,940 |
| Cost of sales and contracts: | | | | |
| Cost of product sales and contracts | 29,775 | 21,790 | 48,565 | 40,734 |
| Cost of service revenues | 11,018 | 10,004 | 22,059 | 20,132 |
| Total cost of sales and contracts | 40,793 | 31,794 | 70,624 | 60,866 |
| Gross profit | 39,844 | 29,454 | 63,656 | 55,074 |
| Expenses: | | | | |
| Selling, general and administrative expenses | 10,997 | 8,009 | 20,810 | 16,711 |
| Research and development costs | 5,225 | 4,951 | 10,235 | 10,757 |
| Total operating expenses | 16,222 | 12,960 | 31,045 | 27,468 |
| Operating income | 23,622 | 16,494 | 32,611 | 27,606 |
| Other income (expense): | | | | |
| Interest and investment income | 135 | 138 | 363 | 303 |
| Interest expense | (28) | (33) | (58) | (66) |
| Other, net | (1,082) | (18) | 114 | 112 |
| Total other income (expense) | (975) | 87 | 419 | 349 |
| Income before provision for income taxes | 22,647 | 16,581 | 33,030 | 27,955 |
| Provision for income taxes | 7,978 | 5,886 | 11,560 | 9,924 |
| Net income | \$ 14,669 | \$ 10,695 | \$ 21,470 | \$ 18,031 |
| Income per share Basic | \$ 1.63 | \$ 1.21 | \$ 2.38 | \$ 2.04 |
| Income per share Diluted | \$ 1.59 | \$ 1.18 | \$ 2.33 | \$ 2.00 |
| Weighted average shares Basic | 9,020 | 8,857 | 9,020 | 8,836 |
| Weighted average shares Diluted | 9,221 | 9,064 | 9,219 | 9,037 |
| Dividends declared per share | \$ 0.30 | \$ 0.20 | \$ 0.60 | \$ 0.40 |

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

Table of Contents

AMERICAN SCIENCE AND ENGINEERING, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

| (In thousands) | For the Six Months Ended | |
|--|--------------------------|-----------------------|
| | September 30, 2010 | September 30, 2009 |
| Cash flows from operating activities: | | |
| Net income | \$ 21,470 | \$ 18,031 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 2,396 | 2,251 |
| Provisions for contracts, inventory and accounts receivable reserves | 465 | 948 |
| Amortization of bond premium | 1,041 | 207 |
| Deferred income taxes | 1,155 | 313 |
| Mark-to-market of foreign currency put option contract | (122) | |
| Stock compensation expense | 2,563 | 2,658 |
| Changes in assets and liabilities: | | |
| Accounts receivable | (6,698) | 5,455 |
| Unbilled costs and fees | (13,289) | 4,502 |
| Inventories | (7,005) | 4,029 |
| Prepaid expenses and other assets | 2,724 | (184) |
| Accounts payable | 5,826 | (1,520) |
| Accrued income taxes | (3,413) | 1,620 |
| Customer deposits | (2,438) | 3,103 |
| Deferred revenue | (572) | (17,945) |
| Accrued expenses and other liabilities | (1,848) | (8,099) |
| Net cash provided by operating activities | 2,255 | 15,369 |
| Cash flows from investing activities: | | |
| Purchases of short-term investments | (99,224) | (102,178) |
| Proceeds from sales and maturities of short-term investments | 127,695 | 46,265 |
| Purchases of property and equipment | (2,899) | (1,390) |
| Net cash provided by (used for) investing activities | 25,572 | (57,303) |
| Cash flows from financing activities: | | |
| Increase in restricted cash and investments | | (1,832) |
| Proceeds from exercise of stock options | 366 | 545 |
| Repurchase of shares of common stock | (3,381) | (2,922) |
| Repayment of leasehold financing | (649) | (574) |
| Payment of common stock dividend | (5,415) | (3,539) |
| Reduction of income taxes paid due to the tax benefit from employee stock option expense | 526 | 57 |
| Net cash used for financing activities | (8,553) | (8,265) |
| Net increase (decrease) in cash and cash equivalents | 19,274 | (50,199) |
| Cash and cash equivalents at beginning of period | 34,912 | 105,419 |
| Cash and cash equivalents at end of period | \$ 54,186 | \$ 55,220 |

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

Table of Contents

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 the Company and its wholly owned subsidiaries. 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 included in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2010.

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 quarterly 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

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.

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, 2010. There have been no changes to our critical accounting policies during the three and six months ended September 30, 2010.

Comprehensive Income

Comprehensive income is comprised of the following:

| (In thousands) | Three Months Ended | | Six Months Ended | |
|----------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2010 | September 30, 2009 | September 30, 2010 | September 30, 2009 |
| Net income | \$ 14,669 | \$ 10,695 | \$ 21,470 | \$ 18,031 |
| Other comprehensive income | 72 | 11 | 40 | 11 |
| Comprehensive income | \$ 14,741 | \$ 10,706 | \$ 21,510 | \$ 18,042 |

Stock Repurchase Program

The Board of Directors approved a Stock Repurchase Program which authorized the Company to repurchase up to \$35.0 million of shares of its common stock from time to time on the open market. During the six months ended September 30, 2010, a total of 46,500 shares were repurchased at an average price of \$72.72 per share. As of September 30, 2010, the maximum dollar value of shares that may still be purchased under the program is \$20,423,000.

Dividends

| (In thousands) | Three Months Ended | | Six Months Ended | |
|--------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2010 | September 30, 2009 | September 30, 2010 | September 30, 2009 |
| Dividends declared | \$ 0.30 | \$ 0.20 | \$ 0.60 | \$ 0.40 |
| Dividends paid | \$ 0.30 | \$ 0.20 | \$ 0.60 | \$ 0.40 |

On November 9, 2010, the Company declared a cash dividend of \$0.30 per share. The dividend will be paid on December 2, 2010 to all shareholders of record at the close of business on November 22, 2010. 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.

Table of Contents**Concentrations of Credit Risk**

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist primarily of cash and cash equivalents, 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 high quality U.S. treasury bills, high quality money market funds, commercial paper, investment grade corporate debentures / bonds, U.S. Government agency bonds and certificates of deposit.

Recent Accounting Pronouncements

In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2009-14, *Revenue Recognition (Topic 605) Applicability of AICPA Statement of Position 97-2 to Certain Arrangements That Include Software Elements* (ASU 2009-14). ASU 2009-14 excludes tangible products containing software components and non-software components that function together to deliver the product's essential functionality from the scope of FASB Accounting Standards Codification (ASC) 605-985, *Software-Revenue Recognition*. ASU 2009-14 shall be applied on a prospective basis to revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. Upon adoption, the Company must apply ASU 2009-14 retrospectively to the beginning of the fiscal year of adoption or to all periods presented. The Company is currently evaluating the impact of the pending adoption of ASU 2009-14 on its Consolidated Financial Statements.

2. ACCOUNTING FOR STOCK-BASED COMPENSATION

The Company accounts for stock based awards made to employees and its Board of Directors in accordance with 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 \$1,539,000 and \$1,438,000 of share-based compensation costs in the consolidated statements of operations for the three months ended September 30, 2010 and September 30, 2009, respectively. The Company recognized \$2,563,000 and \$2,658,000 of share-based compensation costs in the consolidated statements of operations for the six months ended September 30, 2010 and September 30, 2009, respectively. The income tax benefit recognized related to this compensation for the three months ended September 30, 2010 and September 30, 2009 was approximately \$532,000 and \$510,000, respectively. The income tax benefit related to this compensation for the six months ended September 30, 2010 and September 30, 2009 was approximately \$895,000 and \$940,000, respectively.

The following table summarizes share-based compensation costs included in the Company's consolidated statement of operations:

| (In thousands) | Three Months Ended | | Six Months Ended | |
|----------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2010 | September 30, 2009 | September 30, 2010 | September 30, 2009 |

Edgar Filing: AMERICAN SCIENCE & ENGINEERING, INC. - Form 10-Q

| | | | | | | | | |
|---|----|-------|----|-------|----|-------|----|-------|
| Cost of revenues | \$ | 242 | \$ | 199 | \$ | 395 | \$ | 408 |
| Selling, general and administrative | | 1,297 | | 1,239 | | 2,168 | | 2,250 |
| Total share-based compensation expense before tax | \$ | 1,539 | \$ | 1,438 | \$ | 2,563 | \$ | 2,658 |

The Company deems the Black-Scholes option pricing model as the most appropriate method for determining the estimated fair value for the stock awards. The Black-Scholes method of valuation requires several assumptions: (1) the expected term of the stock 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 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 was based on the expectation we would continue paying dividends on our common stock at the same rate for the foreseeable future.

There were 56,181 and 63,993 options granted in the six month period ended September 30, 2010 and September 30, 2009, respectively. The fair value of the options at date of grant was estimated with the following assumptions for grants made during the period presented:

| Assumptions: | Six Months Ended | |
|-------------------------|-----------------------|-----------------------|
| | September 30, 2010 | September 30, 2009 |
| Option life | 5 years | 5 years |
| Risk-free interest rate | 1.5% | 2.4% |
| Stock volatility | 44% | 46% |
| Dividend yield | 1.6% | 1.24% |

Table of Contents**Stock Option and Other Compensation Plans**

The Company has various stock option and other compensation plans for non-employee directors, officers, and employees. The Company had the following stock option and other compensation plans outstanding as of September 30, 2010: the 1995 Combination Plan, the 1997 Non-Qualified Option Plan, the 1998 Non-Qualified Option Plan, the 1999 Combination Plan, the 2000 Combination Plan, the 2002 Combination Plan, the 2003 Stock Plan for Non-Employee Directors and the 2005 Equity and Incentive Plan. There are 3,980,000 shares authorized under these plans. As of September 30, 2010, 309,000 shares remain available for future issuance under these plans. Vesting periods are at the discretion of the Compensation Committee of the Board of Directors, or their designee, and typically range between one and three years. Options under these plans are granted at fair market value and have a term of five or ten years from the date of grant.

Stock Options

The following tables summarize stock option activity for the six months ended September 30, 2010.

| | Number of Shares | Weighted Average Exercise Price | Weighted Average Contractual Life (years) | Aggregate Intrinsic Value |
|--|---------------------|--|---|---------------------------------|
| Options outstanding at March 31, 2010 | 613,934 | \$ 47.38 | 5.27 | |
| Grants | 56,181 | 74.87 | | |
| Exercises | (18,035) | 20.29 | | \$ 962,000 |
| Cancellations | | | | |
| Options outstanding at September 30, 2010 | 652,080 | \$ 50.49 | 5.33 | |
| Options exercisable at September 30, 2010 | 575,226 | \$ 47.88 | | \$ 14,833,000 |

Information related to the stock options outstanding as of September 30, 2010 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 |
|--------------------------|---------------------|--|--|------------------------------------|---|
| \$ 6.50 - \$20.00 | 73,070 | 2.97 | \$ 13.14 | 73,070 | \$ 13.14 |
| \$20.01 - \$30.00 | 65,834 | 3.73 | 28.12 | 65,834 | 28.12 |
| \$30.01 - \$40.00 | 31,650 | 4.18 | 39.07 | 31,650 | 39.07 |
| \$40.01 - \$50.00 | 71,000 | 4.83 | 45.84 | 71,000 | 45.84 |
| \$50.01 - \$60.00 | 127,721 | 4.88 | 53.33 | 123,860 | 53.38 |
| \$60.01 - \$70.00 | 226,624 | 5.99 | 64.45 | 205,631 | 64.72 |
| \$70.01 - \$75.82 | 56,181 | 9.92 | 74.87 | 4,181 | 75.82 |
| \$ 6.50 - \$75.82 | 652,080 | 5.33 | \$ 50.49 | 575,226 | \$ 47.88 |

As of September 30, 2010, there was approximately \$1,479,000 of unrecognized compensation costs related to options granted. This cost is expected to be recognized over a weighted average period of 0.9 years. Non-vested common stock options are subject to the risk of forfeiture until the fulfillment of specified conditions.

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 stock which vests 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 on January 10th the Board of Directors is granted restricted stock. These restricted stock shares vest on a pro-rata basis on service time performed over a one-year period. The fair values of these restricted stock 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 stock unit awards are subject to the risk of forfeiture until the fulfillment of specified conditions.

Table of Contents

As of September 30, 2010 there was \$2,258,000 of total unrecognized compensation cost related to non-vested restricted stock and stock unit awards granted under the Company's stock plans. This cost is expected to be recognized over a weighted average period of 1.2 years.

The following table summarizes the status of the Company's non-vested restricted stock and stock unit awards for the six months ended September 30, 2010:

| | Number of Shares | Weighted Average Grant Date Fair Value |
|--|---------------------|--|
| Outstanding at March 31, 2010 | 97,240 | \$ 60.78 |
| Granted | 366 | 75.82 |
| Vested | (4,018) | 66.51 |
| Forfeited | | |
| Outstanding at September 30, 2010 | 93,588 | \$ 60.59 |

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. Excessive 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, 2010 and March 31, 2010 were as follows:

| (In thousands) | September 30, 2010 | March 31, 2010 |
|--|-----------------------|-------------------|
| Raw materials, completed sub-assemblies, and spare parts | \$ 28,631 | \$ 19,821 |
| Work-in-process | 19,611 | 15,813 |
| Finished goods | 3,768 | 9,753 |
| Total | \$ 52,010 | \$ 45,387 |

4. INCOME PER COMMON AND COMMON EQUIVALENT SHARE

Basic earnings per common share is computed by dividing net income available to common stockholders by the weighted average number of shares of common stock outstanding during the period. 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, 2010 and September 30, 2009, common stock equivalents of 77,000 and 94,000, respectively, are excluded from diluted earnings per share, as their effect is anti-dilutive. For the six months ended September 30, 2010 and September 30, 2009, common stock equivalents of 78,000 and 146,000, respectively, are excluded from diluted earnings per share, as their effect is anti-dilutive.

Edgar Filing: AMERICAN SCIENCE & ENGINEERING, INC. - Form 10-Q

| (In thousands except per share amounts) | Three Months Ended | | Six Months Ended | |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2010 | September 30, 2009 | September 30, 2010 | September 30, 2009 |
| Income Per Share | | | | |
| Basic: | | | | |
| Net income | \$ 14,669 | \$ 10,695 | \$ 21,470 | \$ 18,031 |
| Weighted average number of common shares outstanding basic | 9,020 | 8,857 | 9,022 | 8,836 |
| Net income per share basic | \$ 1.63 | \$ 1.21 | \$ 2.38 | \$ 2.04 |
| Diluted: | | | | |
| Net income | \$ 14,669 | \$ 10,695 | \$ 21,470 | \$ 18,031 |
| Weighted average number of common shares outstanding | 9,020 | 8,857 | 9,020 | 8,836 |
| Assumed exercise of stock options and restricted stock units, using the treasury stock method | 201 | 207 | 199 | 201 |
| Weighted average number of common and potential common shares outstanding diluted | 9,221 | 9,064 | 9,219 | 9,037 |
| Net income per share diluted | \$ 1.59 | \$ 1.18 | \$ 2.33 | \$ 2.00 |

Table of Contents

5. LINE OF CREDIT

The Company is party to a Loan and Security Agreement with Silicon Valley Bank providing a \$30.0 million facility to support the Company's routine letters of credit and working capital needs. If the Company maintains a cash and investments balance of \$40.0 million or greater, then the maximum amount available for borrowing under the facility is \$30.0 million minus the amount of all outstanding letters of credit less certain reserves, and minus the outstanding principal balance of any advances. If the Company's cash and investments balance falls below \$40.0 million for a period of 30 consecutive days, then the maximum amount available for borrowings under the facility is the lesser of (i) \$30.0 million, or (ii) 80% of eligible domestic accounts receivable minus the amount of outstanding letters of credit adjusted for certain reserves and minus the principal balance of any advances.

The credit facility bears an interest rate of the greater of 4.0% or the Silicon Valley Bank prime rate (4.0% at September 30, 2010). The credit agreement is collateralized by certain assets of the Company and contains certain restrictions, including limitations on the amount of distributions that can be made to stockholders, and the disposition or encumbrances of assets, and requires the maintenance of certain financial covenants. As of September 30, 2010, the Company was in compliance with these covenants.

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 our obligations; the probability of which management believes is low. As of September 30, 2010, the Company had outstanding \$27,668,000 in standby letters of credit against the Loan and Security Agreement with \$2,332,000 remaining availability. The outstanding letters of credit are primarily for guaranteeing performance on certain international projects. No amounts have been drawn against these letters of credit. At September 30, 2010, the Company had a restricted cash balance of \$35,000 related to certain bank related fees.

The Loan and Security Agreement is set to expire on November 12, 2010 and the Company has decided not to renew this facility as it is not currently needed given its cash flows from operations and available cash and investments balance. Outstanding standby letters of credit will be collateralized with restricted cash and investments upon expiration of the Loan and Security Agreement.

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 the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument.

Financial assets recorded on the Condensed Consolidated Balance Sheets 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

Edgar Filing: AMERICAN SCIENCE & ENGINEERING, INC. - Form 10-Q

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 (examples include corporate and municipal bonds which trade infrequently);
- Inputs other than quoted prices that are observable for substantially the full term of the asset or liability (examples include interest rate and currency swaps); and
- Inputs that are derived principally from or corroborated by observable market data for substantially the full term of the asset or liability (examples include certain securities and derivatives).

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 own 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.

The following table presents the financial assets and liabilities the Company measures at fair value on a recurring basis, based on the fair value hierarchy as of September 30, 2010 and March 31, 2010:

Table of Contents

| (In thousands) | September 30, 2010 | March 31, 2010 |
|---|-----------------------|-------------------|
| Level 1 Financial Assets | | |
| U.S. Treasury bills | \$ 15,134 | \$ 35,005 |
| Level 2 Financial Assets | | |
| Corporate debentures/bonds | 51,387 | 42,588 |
| Government agency bonds | 22,253 | 28,589 |
| Commercial paper | 35,417 | 25,983 |
| Money market funds | 20,203 | 19,705 |
| Certificates of deposit | | 12,001 |
| Total Level 2 Financial Assets | 129,260 | 128,866 |
| Total cash equivalents and short-term investments | \$ 144,394 | \$ 163,871 |

These investments are classified as available-for-sale and are recorded at their fair market values using the specific identification method. The unrealized holding gains or losses on these securities are included as a component of comprehensive income as outlined in Note 1.

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|------------------------------|-------------------|------------------------------|-------------------------------|------------|
| 2010: | | | | |
| Available for Sale: | | | | |
| Corporate debentures/bonds | \$ 51,358 | \$ 45 | \$ (16) | \$ 51,387 |
| Treasury bills | 15,111 | 23 | | 15,134 |
| Commercial paper | 33,418 | | | 33,418 |
| Government agency bonds | 14,749 | 8 | (2) | 14,755 |
| Total short-term investments | \$ 114,636 | \$ 76 | \$ (18) | \$ 114,694 |
| Cash equivalents: | | | | |
| Money market funds | \$ 20,203 | | | \$ 20,203 |
| Commercial paper | 1,999 | | | 1,999 |
| Government agency bonds | 7,500 | | (2) | 7,498 |
| Total cash equivalents | \$ 29,702 | | \$ (2) | \$ 29,700 |

7. DERIVATIVE FINANCIAL INSTRUMENTS

The Company purchased in the fourth quarter of fiscal year 2010 a foreign currency put option contract to manage the risk associated with foreign currency exchange rate fluctuations on an anticipated obligation and transaction, which was outstanding at year end. The foreign currency put option contract was paid in full at execution and was related to our activities in Europe. The put option contract provided us with the option to exchange Euros for U.S. dollars at a fixed exchange rate such that, if the Euro were to depreciate against the U.S. dollar to predetermined levels as set by the contract, we could exercise our option and mitigate our foreign currency exchange losses. This contract did not qualify for hedge accounting treatment and was marked-to-market through the results of operations until it was settled during the current fiscal period. The Company recorded a net mark-to-market income (expense) for this contract of \$(1,020,000) and \$122,000 for the three and six months ended September 30, 2010, respectively, which is included in other income and expense in the condensed consolidated statements of operations. The Company had no option contracts outstanding during the three and six months ended September 30, 2009.

8. 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 year 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, 2007 through 2009 and for various state taxing authorities for the years ending March 31, 2006 through 2009. The Company recently completed an audit by the Internal Revenue Service for tax years ended March 31, 2006 and 2007, the results of which did not have a material impact on the Company's financial position or results of operations. The Company believes that there were no uncertain tax positions that required a reserve as of September 30, 2010.

Table of Contents**9. GUARANTEES**

Certain of the Company's 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 and six months ended September 30, 2010 and 2009 is as follows:

| (In thousands) | Three Months Ended | | Six Months Ended | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2010 | September 30, 2009 | September 30, 2010 | September 30, 2009 |
| Warranty accrual - beginning of period | \$ 834 | \$ 808 | \$ 965 | \$ 1,130 |
| Accruals for warranties issued during the period | 293 | 470 | 471 | 778 |
| Adjustment of preexisting accrual estimates | (90) | (239) | (161) | (694) |
| Warranty costs incurred during the period | (332) | (148) | (570) | (323) |
| Warranty accrual - end of period | \$ 705 | \$ 891 | \$ 705 | \$ 891 |

10. 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, building and tenant improvement and associated lease financing liabilities remain on the Company's books. The lease financing liability is being amortized over the 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.

11. COMMITMENTS AND CONTINGENCIES**Lease Liability**

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, Incorporated. The Company remains secondarily liable for

the remaining lease payments in the event of default by Accuray, Incorporated during the lease term which expires in February 2011. Total remaining lease payments at September 30, 2010 totaled \$143,000. No accrual for this contingent liability has been recorded at September 30, 2010 as management believes the probability of payment of this liability is low.

Deferred Revenue

The Company offers to its customers extended warranty and service contracts. 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. The statements contained in this report that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Without limiting the foregoing, the words may, will, should, could, expects, plans, anticipates, believes, estimates, predicts, potential and similar expressions are intended to identify forward-looking statements. All forward-looking statements included in this Quarterly Report on Form 10-Q are based on information available to us up to, and including, the date of this report, and we assume no obligation to

Table of Contents

update any such forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including the following: significant reductions or delays or cancellation (in full or in part) in procurements of our systems by the United States and other governments; disruption in the supply of any source component incorporated into our products; litigation seeking to restrict the use of intellectual property we use; potential product liability claims against us; 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 our products to address such threats; the potential insufficiency of our resources, including human resources, capital, plant and equipment and management systems, to accommodate any future growth; future delays in federal funding; and other factors discussed in Item 1A Risk Factors and elsewhere in this Form 10-Q. You should carefully review those factors and also carefully review the risks outlined in other documents that we file from time to time with the Securities and Exchange Commission.

Overview

American Science and Engineering, Inc., which is referred to in this report as we or the Company, develops and manufactures state-of-the-art X-ray inspection systems for homeland security, force protection, and other critical defense applications. We provide maintenance, warranty, research, engineering, and training services related to these solutions.

Our primary technologies are: (1) Z Backscatter technology which is used to detect plastic explosives, illegal drugs, and other contraband even when artfully concealed in complex backgrounds; and (2) Shaped Energy X-ray inspection technology which provides high penetration of dense cargoes without excess radiation, eliminating the need for extensive exclusion zones.

Net sales and contract revenues for the second quarter of fiscal 2011 increased by 32% to \$80,637,000 compared to the second quarter of fiscal 2010 revenues of \$61,248,000. We reported income before provision for income taxes of \$22,647,000 for the second quarter of fiscal 2011 compared to \$16,581,000 for the second quarter of fiscal 2010. Net income for the second quarter of fiscal 2011 was \$14,669,000 (\$1.59 per share, on a diluted basis) as compared to net income of \$10,695,000 (\$1.18 per share, on a diluted basis) for the second quarter of fiscal 2010.

Net sales and contract revenues for the first six months of fiscal 2011 increased by 16% to \$134,280,000 compared to the first six months of fiscal 2010 revenues of \$115,940,000. We reported income before provision for income taxes of \$33,030,000 for the first six months of fiscal 2011 compared to \$27,955,000 for the first six months of fiscal 2010. Net income for the first six months of fiscal 2011 was \$21,470,000 (\$2.33 per share, on a diluted basis) as compared to net income of \$18,031,000 (\$2.00 per share, on a diluted basis) for the first six months of fiscal 2010.

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, 2010 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 SEC on June 9, 2010. There have been no changes to our critical accounting policies during the six months ended September 30, 2010.

Results of Operations

Net revenues for the second quarter ended September 30, 2010 increased by \$19,389,000 to \$80,637,000 compared to the corresponding period a year ago. This increase is attributable primarily to an increase of \$17,516,000 in product sales and contract revenues. Factors contributing to the product sales and contract revenues increase include: 1) a \$10,402,000 increase in CargoSearch system revenues as compared to the corresponding prior year period attributable to the delivery of numerous systems accounted for on a completed contract basis; and 2) an increase of \$5,830,000 in Z Backscatter system revenues due to a higher number of units being delivered in the period as compared to the prior year; and 3) an increase of \$847,000 in aftermarket parts revenue due to a higher volume of orders fulfilled in the period. ParcelSearch revenues and contract research and development revenues also increased over the prior period and accounted for \$436,000 of the revenue increase. Service revenues increased by \$1,873,000 to \$20,932,000 compared to the second quarter of fiscal 2010 due primarily to increased service contract revenue as a greater number of systems were under contract as compared to the prior year period.

Net revenues for the six months ended September 30, 2010 increased by \$18,340,000 to \$134,280,000 compared to the corresponding period a year ago. This increase is attributable primarily to an increase of \$15,206,000 in product sales and contract revenues. Factors contributing to the product sales and contract revenues increase include: 1) a \$3,554,000 increase in Z Backscatter

Table of Contents

systems revenues on higher volume; and 2) an increase of \$5,778,000 in CargoSearch system revenues as compared to the corresponding prior year period attributable to an increase in the number of systems delivered and comparably greater progress on certain contracts recognized on a percentage of completion basis; and 3) an increase of \$4,978,000 in ParcelSearch system revenues as compared to the prior year related to one multi unit order fulfilled in the period. Contract research and development and aftermarket parts revenues also experienced increases over the prior period and together accounted for \$895,000 of the revenue increase. Service revenues increased by \$3,134,000 to \$42,101,000 compared to the six months ended September 30, 2009 due primarily to increased service contract revenue as a greater number of systems were under contract as compared to the prior year period.

Total cost of sales and contracts for the second quarter of fiscal 2011 increased by \$8,999,000 to \$40,793,000 as compared to the corresponding period a year ago. Cost of sales and contracts related to product revenues increased by \$7,985,000 to \$29,775,000 as compared to the corresponding period a year ago. Cost of product sales and contract revenues represented 50% of revenues versus 52% of revenues for the corresponding period last year. The resultant increase in gross margin percentage from the prior year is due primarily to improved margins from our CargoSearch product line in the period. We delivered multiple CargoSearch systems in the quarter which had comparably lower unit costs due to manufacturing efficiencies achieved from certain cost-cutting and streamlining efforts implemented over the past 18 months. The cost of service revenues for the quarter ended September 30, 2010 increased by \$1,014,000 to \$11,018,000 as compared to the corresponding period a year ago. Cost of service revenues remained flat at 53% of revenues for both fiscal periods.

Total cost of sales and contracts for the six months ended September 30, 2010 increased by \$9,758,000 to \$70,624,000 as compared to the corresponding period a year ago. Cost of sales and contracts related to product revenues increased by \$7,831,000 to \$48,565,000 as compared to the corresponding period a year ago. Cost of product sales and contract revenues represented 53% of revenues in both the six months ended September 30, 2010 and the six months ended September 30, 2009. Although the gross margin percentage remained flat over the two periods, there was a shift in product mix between the two periods with a greater percentage of revenues deriving from the lower margined CargoSearch and ParcelSearch product lines. These product lines experienced improved margins as compared to the prior fiscal period due primarily to manufacturing efficiencies achieved over the prior periods. The cost of service revenues for the six months ended September 30, 2010 increased by \$1,927,000 to \$22,059,000 as compared to the corresponding period a year ago. Cost of service revenues remained flat at 52% of revenues for both the six months ended September 30, 2010 and the six months ended September 30, 2009.

Selling, general and administrative expenses for the second quarter of fiscal 2011 increased by \$2,988,000 to \$10,997,000 as compared to the corresponding period a year ago. Selling, general and administrative expenses represented 14% of revenues in the current period compared to 13% for the corresponding period last year. The increase in selling, general and administrative expenses over the prior period was primarily the result of: 1) an increase in payroll and payroll-related costs of \$503,000 attributable to increased headcount; 2) an increase in incentive compensation expense of \$1,556,000 attributable to the increased financial performance levels; 3) an increase in legal fees of \$493,000 related primarily to due diligence activities on a potential acquisition which was abandoned during the quarter, and 4) an increase in travel related expenses of \$232,000 related to sales and marketing related travel.

Selling, general and administrative expenses for the six months ended September 30, 2010 increased by \$4,099,000 to \$20,810,000 as compared to the corresponding period a year ago. Selling, general and administrative expenses represented 15% of revenues in the current period compared to 14% for the corresponding period last year. The increase in selling, general and administrative expenses over the prior period was primarily the result of: 1) an increase in payroll and payroll-related costs of \$1,074,000 attributable to increased headcount; 2) an increase in incentive compensation expense of \$1,771,000 attributable to the increased financial performance levels; 3) an increase in legal fees of \$360,000 related primarily to due diligence activities on a potential acquisition which was abandoned during the quarter; 4) an increase in travel related expenses of \$429,000 related primarily to sales and marketing related travel and 5) an increase in sales and marketing related expenses of \$403,000 related to increased sales demo activity and sales conferences held during the period.

Edgar Filing: AMERICAN SCIENCE & ENGINEERING, INC. - Form 10-Q

Company funded research and development expenses for the second quarter of fiscal 2011 increased by \$274,000 to \$5,225,000 as compared to the corresponding period last year. Research and development expenses represented 6% of revenues in the current quarter compared to 8% for the corresponding period last year. The research and development expenses in the quarter were slightly under budget and were attributable to engineering efforts being expended on other routine, non-research and development, production activities. Research and development activities performed in the quarter focused on the development of new product options and product enhancements.

Company funded research and development expenses for the six months ended September 30, 2010 decreased by \$522,000 to \$10,235,000 as compared to the corresponding period last year. Research and development expenses represented 8% of revenues for the six months ended September 30, 2010 as compared to 9% for the corresponding period last year. This decrease in research and development expenses in the period was attributable to engineering efforts being expended on other routine, non-research and development, production activities. Research and development activities performed in the period focused on the development of new product options and product enhancements.

Table of Contents

Other income (expense) was \$975,000 of expense for the second quarter of fiscal 2011 as compared to \$87,000 of income for the corresponding period a year ago. This expense is attributable primarily to a mark-to-market loss of \$1,020,000 recognized on a foreign currency put option contract which depreciated significantly during the quarter due to the volatility of the Euro during the period. This contract had appreciated significantly in the first quarter of fiscal 2010 resulting in a \$1,142,000 gain in that period. This contract did not qualify for hedge accounting treatment under the Derivatives and Hedging Topic of the FASB ASC. Therefore, all gains or losses on the foreign currency put option contract were recorded in our Condensed Consolidated Statements of Operations. This put option was sold during the quarter ended September 30, 2010 at a price near cost resulting in no material gain or loss.

Other income was \$419,000 of income for the six months ended September 30, 2010 as compared to \$349,000 of income for the corresponding period a year ago. This increase in other income is attributable primarily to an increase in investment income due to an increase in the average investment balance as compared to the prior period.

We reported pre-tax income of \$22,647,000 in the three months ended September 30, 2010 as compared to pre-tax income of \$16,581,000 in the corresponding period due to the factors described above. We reported pre-tax income of \$33,030,000 in the six months ended September 30, 2010 as compared to pre-tax income of \$27,955,000 in the corresponding period due to the factors described above.

Our effective tax rate for the three months ended September 30, 2010 was 35.2% as compared to 35.5% for the corresponding period a year ago. Our effective tax rate for the six months ended September 30, 2010 was 35.0% as compared to 35.5% for the corresponding period a year ago. This decline in the tax rate is attributable primarily to a reduced state tax apportionment and an increase in the qualifying manufacturing tax credits as compared to the prior year offset in part by an increase in non-deductible executive compensation under Section 162(m) of the Internal Revenue Code.

We had net income of \$14,669,000 for the second quarter of fiscal 2011 as compared to net income of \$10,695,000 in the second quarter of fiscal 2010. We had net income of \$21,470,000 for the six months ended September 30, 2010 as compared to net income of \$18,031,000 in the six months ended September 30, 2009. The significant factors contributing to these results are noted in the above sections.

Liquidity and Capital Resources

Our sources of capital include, but are not limited to, our cash flows from operations, our line of credit, and cash received from stock issuances from option exercises. As is noted below, our line of credit is set to expire in November of 2010 and we have decided not to renew this facility at that time. 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, performance guarantee collateralizations, and share repurchases for the foreseeable future.

Summary of Cash Activities

Edgar Filing: AMERICAN SCIENCE & ENGINEERING, INC. - Form 10-Q

Cash and cash equivalents increased by \$19,274,000 to \$54,186,000 at September 30, 2010 compared to \$34,912,000 at March 31, 2010. This increase is attributable primarily to: 1) the net income earned in the period adjusted for certain non-cash items; 2) a net decrease of \$28,471,000 in short-term investments as we liquidated certain short-term investments into cash equivalents during the period; and 3) an increase in accounts payable of \$5,826,000 attributable to an increase in end of period purchasing activity. Offsetting these inflows were other operating cash outflows including: 1) increases in unbilled receivables of \$13,289,000 due to the milestone invoicing terms on certain contracts delivered during the current quarter; 2) increases in accounts receivable of \$6,698,000 attributable to the higher revenue in the period and the timing of certain contract milestone invoices and payments; 3) increases in inventories of \$7,005,000 from year end attributable to a buildup of inventory to meet delivery schedules of orders in backlog; and 4) decreases in customer deposits of \$2,438,000 during the period as milestone payments received in the prior year were earned and converted to revenue in the current fiscal year. In addition, we paid \$5,415,000 in dividends to shareholders as part of our quarterly dividend program and used \$3,381,000 to repurchase 46,500 shares of common stock as part of our Stock Repurchase Program.

Credit Facility

We are party to a Loan and Security Agreement with Silicon Valley Bank providing a \$30.0 million facility to support our routine letters of credit and working capital needs. If we maintain a cash and investments balance of \$40.0 million or greater, then the maximum amount available for borrowing under the facility is \$30.0 million minus the amount of all outstanding letters of credit less certain reserves, and minus the outstanding principal balance of any advances. If our cash and investment balance falls below \$40.0 million for a period of 30 consecutive days, then the maximum amount available for borrowings under the facility is the lesser of (i) \$30.0 million, or (ii) 80% of eligible domestic accounts receivable minus the amount of outstanding letters of credit adjusted for certain reserves and minus the principal balance of any advances.

The credit facility bears an interest rate of the greater of 4.0% or the Silicon Valley Bank prime rate (4.0% at September 30, 2010).

Table of Contents

The credit agreement is collateralized by certain of our assets and contains certain restrictions, including limitations on the amount of distributions that can be made to stockholders, and the disposition or encumbrances of assets, and requires the maintenance of certain financial covenants. As of September 30, 2010, we were in compliance with these covenants.

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, 2010, we had outstanding \$27,668,000 in standby letters of credit against the Loan and Security Agreement with \$2,332,000 remaining availability. The outstanding letters of credit are primarily for guaranteeing performance on certain international projects. No amounts have been drawn against these letters of credit. At September 30, 2010, we had a restricted cash balance of \$35,000 related to certain bank related fees.

The Loan and Security Agreement is set to expire on November 12, 2010 and we have decided not to renew this facility as it is not currently needed given our cash flows provided from operations and our available cash and investments balance. We have not drawn on this facility to fund operations since June of 2002 and have used this credit facility exclusively to issue standby letters of credit. Upon expiration of the Loan and Security Agreement, outstanding standby letters of credit will be collateralized with restricted cash and investments.

ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The cash accounts for our operations in Hong Kong, England, the Netherlands, and Abu Dhabi are maintained in Hong Kong dollars, pounds sterling, Euros and dirham, respectively. The gains and losses from foreign currency transactions are included in the condensed consolidated statements of operations for the period and were immaterial. During the six months ended September 30, 2010, we held a foreign currency put option which provided us with the option to exchange Euros for U.S. dollars at a fixed exchange rate such that, if the Euro were to depreciate against the U.S. dollar to predetermined levels as set by the contract, we could exercise our option and mitigate our foreign currency exchange losses. This put option was sold during the quarter ended September 30, 2010 at a price near cost resulting in no material gain or loss. A hypothetical 10 percent change in foreign currency rates would not have a material impact on our results of operations or financial condition.

As of September 30, 2010, we held short-term investments consisting of U.S. treasury bills, money market funds, commercial paper, corporate debentures/bonds, and government agency bonds. Our primary objective with our investment portfolio is to invest available cash while preserving principal and meeting liquidity needs. These investments have an average interest rate of approximately 0.354% 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.

ITEM 4 CONTROLS AND PROCEDURES

- a) Evaluation of disclosure controls and procedures

Edgar Filing: AMERICAN SCIENCE & ENGINEERING, INC. - Form 10-Q

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, 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 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 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, the Company's 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 year ended March 31, 2010. There have been no material changes from the factors disclosed in our Form 10-K for the year ended March 31, 2010, although we

Table of Contents

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

The following table provides information about our purchases during the quarter ended September 30, 2010 of equity securities that are registered by us pursuant to Section 12 of the Exchange Act.

| Quarter ended September 30, 2010 | | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Programs | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Programs |
|----------------------------------|--------------|----------------------------------|------------------------------|---|---|
| July 1 | July 31 | | \$ | | \$ 23,807,000 |
| August 1 | August 31 | 22,500 | 71.88 | 22,500 | 22,190,000 |
| September 1 | September 30 | 24,000 | 73.51 | 24,000 | 20,423,000 |
| Total | | 46,500 | \$ 72.72 | 46,500 | \$ 20,423,000 |

(1) On May 13, 2008, our Board of Directors announced a Stock Repurchase Program which authorizes us to repurchase up to \$35 million of shares of our common stock from time to time on the open market. As of September 30, 2010, the maximum dollar value of shares that may yet be purchased under this program is \$20,423,000.

ITEM 4 [REMOVED AND RESERVED]**ITEM 6 EXHIBITS**

See the exhibit index following the signature page to this quarterly report.

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.

Table of Contents

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: November 9, 2010

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

Table of Contents

EXHIBIT INDEX

| Exhibit Number | Description of Exhibits |
|---------------------------|--|
| 10.1 | Form of Indemnification Agreement between American Science and Engineering, Inc. and each of its directors and executive officers (filed as Exhibit 10.1 to the Company's Report on Form 8-K dated September 8, 2010 and incorporated herein by reference) |
| 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 |