AERO SYSTEMS ENGINEERING INC
Form 10-K
March 13, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2002 Commission file number 0-7390

AERO SYSTEMS ENGINEERING, INC.
(Exact name of registrant as specified in its charter)

Minnesota (State of incorporation)	41-0913117 (I.R.S. Employer Identification No.)
358 East Fillmore Avenue, St. Paul, Minnesota (Address of principal executive offices)	55107 (Zip Code)
Registrant's telephone number, including area code	(651) 227-7515

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

Common Stock, Par Value $.20 Per Share
(Title of Class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding twelve months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes |X| No | |

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

Indicate by checkmark whether the registrant is an accelerated filer (as defined in Rule 126-2 of the Act).

Yes | | No |X|

The aggregate market value of the voting stock and non-voting held by nonaffiliates of the registrant as of January 31, 2003 was approximately $3,396,639 based upon the average of the closing bid and asked prices of the stock on such date.

The number of common shares outstanding as of January 31, 2003 was 4,401,625.

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DOCUMENTS INCORPORATED BY REFERENCE

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

DOCUMENT	PARTS OF FORM 10-K INTO WHICH INCORPORATED BY REFERENCE
Proxy Statement to be filed on or before April 25, 2003 for the annual meeting of shareholders on May 28, 2003	III (Parts 10 through 13)

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

DOCUMENT	SUBJECT HEADINGS IN PROXY STATEMENT
Item 10. Directors and Executive Officers of the Registrant	Election of Directors
Item 11. Executive Compensation	Election of Directors
Item 12. Security Ownership of Certain Beneficial Owners and Management	Principal Shareholders
Item 13. Certain Relationships and Related Transactions	Election of Directors
Item 14. Not Incorporated by Reference	

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PART I

ITEM 1 - BUSINESS

General Development of Business - Aero Systems Engineering, Inc. (ASE or the Company) is a global turnkey provider of test facilities and systems for the aerodynamic and propulsion test system markets. ASE is a Minnesota corporation that was organized on May 11, 1967. The Company is primarily engaged in selling products and services related to testing turbine engines, and the business of designing, constructing, and supplying various types of test facilities, such as wind tunnels and other aerodynamic test facilities. The Company also owns an Aerotest Laboratory, which provides aeropropulsion component and aerodynamic testing services.

Prior to September 25, 2001, approximately 80% of the Company's outstanding common stock was owned by Celsius Inc., a wholly owned subsidiary of Saab AB, which is a Swedish company. On September 25, 2001, Minnesota ASE, LLC acquired 2,245,000 shares of common stock of Aero Systems Engineering, Inc. from Celsius Inc., representing 51% of the Company's outstanding shares. Celsius Inc. retains a 29% stock interest in the Company.

On October 17, 2002, the Company announced that it had entered into an agreement with Goldsmith Agio Helms to assist the Company in exploring strategic alternatives, including alternatives involving business combinations and a sale of the stock of the Company. The Company indicated that this action was initiated because of the recognition, among other things, that the Company has little stock float, that the trading price of the Company's stock was dramatically affected by relatively small stock transactions, and like so many companies, the Company had become an "orphan" company from the standpoint of the stock market. Further, access to the resources of a larger organization could facilitate more rapid growth in the Company's current and expanded markets. There is no deadline for completing the process and the Company does not presently intend to offer additional comments about these matters unless and until the Company decides to proceed with a material transaction or decide to no longer pursue the process.

The plan of operations for 2003 with respect to the Company is to continue with its current activities and operations in the test cell, wind tunnel, and aerodynamic testing markets. In addition, the Company plans to explore new markets as deemed appropriate through acquisitions or using joint ventures with established companies. Currently, the Company has no such agreements regarding such opportunities. The Company is expanding into the industrial engine and small commuter engine testing marketplace. In regards to this type of expansion, the Company signed an exclusive services agreement with Honeywell in early 2002 where the Company will function as the exclusive subcontractor to Honeywell to provide design, engineering, and fabrication services for Honeywell engine test cells sold to third parties. Also, acoustic measurement processes to measure noise levels are technologies whereby the Company is creating new customers and providing additional value to existing customers.

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

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

- Design and overall project management for construction of jet engine testing facilities and wind tunnel test facilities;

- Design and manufacture of electronic and mechanical turbine engine testing equipment;

- Providing of aerodynamic and propulsion system testing services;

- Application of engineering technology to specific engine and aerodynamic testing problems;

- Providing acoustic design and measurement services.

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

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

The Company does not generally produce products as inventory items; rather, the Company's products are usually made to order and are limited to individual application and adaptation. The Company does build and inventory limited amounts of selected electronic products and spare parts and components for customer support.

Most of the instrumentation and much of the equipment used in a jet engine or wind tunnel test facility are not manufactured by the Company, but are manufactured for the Company by suppliers. The Company adds value by combining these electronic and mechanical components purchased from other companies and assembling them to make the desired testing equipment or facility. For a complete test facility, the Company designs the testing facility but subcontracts the civil engineering work and construction to local civil construction companies.

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

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

Patents and Trademarks - The Company currently owns several patents relating to a free piston shock tube and for a test cell stack design. The Company has applied to various foreign countries' patent offices to register the U.S. patents in those countries. The Company has three patent applications in process at the time of this filing. One is for a plate fin heat exchanger application, the second is for an automotive wind tunnel open jet collector design, and the third is for an improved noise reduction system for free-fall simulators.

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

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

Working Capital - The Company has no need to and does not maintain significant amounts of inventory or supplies. The Company does not generally grant extended payment terms to customers. However, because certain of the Company's contracts with its customers extend over multiple years, outstanding balances due from a customer may be quite large. The Company is occasionally required to issue standby letters of credit as a guarantee for customers' advances and performance of the project by the Company. Additionally, in various governmental contracts, there are retainages, usually 5% to 10%, that are held back by governmental agencies to ensure contract performance. The Company's practices concerning inventory and credit are consistent with practices in the industry.

The Company has consistently relied upon bank credit lines during recent years as a source of its working capital resources and liquidity. During the third quarter 2001, Celsius Inc. sold 51% of the total outstanding shares of common stock of ASE to Minnesota ASE, LLC. Related to this transaction, the Company secured new bank financing agreements for operating funds and future letter of credit needs. These agreements are asset-based collateral agreements, with the funds available under these agreements determined by the available securable assets at any point in time, up to a maximum of $6,000,000 of operating funds and $3,000,000 of letter of credit funds. Also related to the transaction, Celsius Inc. agreed to continue to hold until maturity certain existing bank guarantees that were previously provided to a few of the Company's customers, and Celsius Inc. provided a three-year $1,500,000 loan to the Company at 8% per year, which is subordinated debt to the bank agreement. This loan is collateralized by a third party pledge by Minnesota ASE, LLC of the shares of ASE purchased by Minnesota ASE, LLC from Celsius Inc. The Company has provided an indemnification agreement to Celsius Inc. to secure Celsius Inc.'s interest in the above items. On September 25, 2001, Minnesota ASE, LLC loaned the Company $2,600,000 in order to supplement bank financing, and $2,300,000 of the balance was repaid prior to December 31, 2001. During 2002, Minnesota ASE, LLC loaned the Company an additional $200,000, leaving an outstanding balance of $500,000 at December 31, 2002.

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Customers - The Company provides products and services for numerous companies in the aerospace industry as well as the U.S. federal government and foreign governmental entities. The orders to provide these services can originate from many customers and quite frequently result in repeat business. In 2002, three customers each accounted for more than 10% of the Company's revenues. These three customers were the United States Government, General Electric, and DSO-Singapore. In aggregate, these three customers accounted for approximately 49% of 2002 revenue. The Company believes that the loss of no other single customer would have a material adverse effect on its future revenues. In 2001 and 2000, three customers each accounted for more than 10% of the Company's revenues. These three customers were Boeing, General Electric, and DSO-Singapore.

Backlog - The Company's order backlog constitutes future revenue to be earned on contracts, including unearned revenue on projects currently in progress. The backlog of orders as of December 31, 2002 was $21,308,000. This compares with a backlog of $29,483,000 on December 31, 2001. Although backlog did decrease from $29.5 million at the end of 2001 to $21.3 million at the end of 2002, this was largely due to the work performed in 2002 on the three-year Singapore wind tunnel project.

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

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

The Company has in the past been aided in financing projects by utilizing the financial strength of Celsius AB, which is now a subsidiary of Saab AB. Without the ability to issue standby letters of credit to guarantee the Company's performance, ASE might not have been the prime contractor on certain of these projects.

Research and Development - Research and development performed by the Company is applied engineering, that is, applying present engineering knowledge and technology toward solving customer problems in turbine engine and aerodynamic testing. The Company is currently enhancing the ASE2000, which is its latest computer data acquisition system. The expense of research and development was $368,000, $421,000, and $625,000 for the years ended December 31, 2002, 2001, and 2000, respectively.

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

Employees - As of December 31, 2002, the Company had 180 employees. Additionally, contract labor has been used as business conditions require. There are currently no collective bargaining agreements covering any of the Company's employees. The Company has not experienced a strike or work stoppage, and management believes that its employee relations are good.

Foreign Operations - While business in foreign countries is always subject to interference or restrictions by foreign governments or restrictions imposed by the United States government, the Company believes that the nature of its business is such that it is not likely to be subject to such interference. However, wind tunnels with a Mach number in excess of 0.9 require approval from the U.S. State Department if they are sold to a foreign country. The Company expects that a significant amount of international business will continue through 2003.

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

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ITEM 2 - PROPERTIES

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

The Company leases from the Port Authority a building that has 24,000 square feet of manufacturing and warehouse space located at 181 East Florida Street, Saint Paul, Minnesota. When the lease agreement expired in July 2002, the Company had the option to purchase the facility for approximately $95,000. As of December 31, 2002, the Company has provided notification of its intention to exercise the purchase option, but has not yet closed on the property due to title issues. The Company continues to utilize the building and intends to purchase the building when the title issues are resolved, which is expected to be shortly. Current properties are expected to be adequate to meet the needs of the Company for the foreseeable future.

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

The Company leases 1,510 square feet of office space in Hampton, Virginia. This office space was subleased by another company until recently. The Company is currently searching for a new tenant. The Company no longer has any employees located in this facility, and the remaining lease is in effect until April 2004.

ITEM 3 - LEGAL PROCEEDINGS

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

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

No matter was submitted during the fourth quarter of 2002 to a vote of security holders through the solicitation of proxies or otherwise.

PART II

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

The Company's common stock currently is quoted on The Nasdaq SmallCap Market(SM). On January 31, 2003, the closing sale price for the Company's common stock was $4.45.

The high and low sales prices for the Company's common stock for each quarter during 2000 and 2001, as quoted on Nasdaq, were as follows:

	HIGH	LOW
2002:		
First Quarter	2.80	1.36
Second Quarter	4.84	1.86
Third Quarter	8.00	3.91
Fourth Quarter	7.71	3.01

2001:		
First Quarter	$1.88	$1.44
Second Quarter	1.74	1.30
Third Quarter	1.60	.91
Fourth Quarter	2.85	.88

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

No cash dividends have ever been paid in the history of the Company. The Company's Board of Directors reviews the Company's dividend policy at least annually. As of December 31, 2002, there were approximately 178 holders of record of common stock of the Company and 4,401,625 total shares outstanding.

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ITEM 6 - SELECTED FINANCIAL DATA

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

	2002	2001	2000	1999	1998
SELECTED INCOME STATEMENT DATA					
Earned revenue	$40,856,807	$27,182,583	$ 30,646,114	$ 31,061,082	$ 27,181,
Net income (loss)	2,360,073	270,938	331,003	(645,307)	665,
Net income (loss) per common share	.54	.06	.08	(.15)	
Weighted average common shares outstanding	4,401,625	4,401,625	4,401,625	4,401,625	4,401,
SELECTED BALANCE SHEET DATA					
Current assets	$18,809,918	$11,243,385	$ 13,043,123	$ 14,180,121	$ 15,424,
Current liabilities	13,738,791	9,375,300	13,506,301	15,368,305	15,750,
Working capital	5,071,127	1,868,085	(463,178)	(1,188,184)	(326,
Total assets	22,931,106	15,856,797	18,226,831	19,808,689	20,899,
Long-term debt and capital lease obligations	1,582,020	1,609,755	119,726	170,583	234,
Stockholders' equity	7,231,817	4,871,742	4,600,804	4,269,801	4,915,

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

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

Results of Operations - Earned revenue for the year ended December 31, 2002 was $40,857,000, an increase of $13,674,000 or 50% as compared to 2001 revenue of $27,183,000. Earned revenue for 2000 was $30,646,000. The revenue increase from

2001 to 2002 was mostly attributable to the increase in orders in process, resumption of normal activities on the Singapore wind tunnel project since receipt of the export license in early September 2001 and success in new initiatives. The revenue decrease from 2000 to 2001 was mostly due to the delay of U.S. government approval of the export license application for the wind tunnel project in Singapore. The export license was submitted for approval during the fourth quarter of 2000. Because of this delay, work on the project had been very limited during 2001, resulting in lower revenue and margin recognition.

The cost of earned revenue, which includes manufacturing and engineering costs, was 77% of earned revenue in 2002 as compared to 75% in 2001 and 78% in 2000. The percentage increase in cost of earned revenue during 2002 was mostly the result of work shifting to slightly lower margin projects in the wind tunnel portion of the business during 2002. The percentage decrease in cost of earned revenue during 2001 was mostly due to the fact that there were no occurrences of major cost overruns on any of the projects during 2001 as compared to 2000 and generally the projects that were in process during 2001 were slightly lower cost projects.

The Company recognizes revenue and profit as work on long-term contracts progresses using the percentage-of-completion method of accounting, which relies on estimates of total expected contract revenues and costs. The Company follows this method since reasonably dependable estimates of the revenue and costs applicable to various stages of a contract can be made. Because the financial reporting of these contracts depends on estimates, which are assessed continually during the term of the contract, recognized revenues and profit are subject to adjustments as the contract progresses to completion. Revisions in profit estimates are reflected in the period in which the facts that give rise to the revision become known. Accordingly, favorable changes in estimates result in additional profit recognition, and unfavorable changes in estimates result in the reversal of previously recognized revenue and profits. When estimates indicate a loss under a contract, cost of revenue is charged with a provision for such loss. As work progresses under a loss contract, revenue continues to be recognized, and a portion of the contract costs incurred in each period is charged to the contract loss reserve.

The backlog of orders as of December 31, 2002 was $21,308,000, which consisted of $19,741,000 that was related to jet engine test cell projects and wind tunnel projects and $1,567,000 related to Aerotest Lab/Other. Backlog of orders as of December 31, 2001 was $29,483,000, of which $27,630,000 was related to test cell and wind tunnel projects and $1,853,000 related to Aerotest Lab/Other. Backlog of orders as of December 31, 2000 was $27,710,000, of which $26,221,000 was related to test cell and wind tunnel projects and $1,489,000 related to Aerotest Lab/Other.

The change in backlog from 2001 to 2002 represents a 28% decrease in total backlog. New orders received in 2002 totaled $32,692,000 as compared to the previous year of $28,995,000. The 2002 decrease in backlog was mostly related to the conversion of backlog into revenue on the large Singapore wind tunnel project. The change in backlog from 2000 to 2001 represents a 6% increase in total backlog. The 2001 increase in backlog was mostly related to the strong order intake during the second half of 2001.

Operating expenses were $5,916,000, $5,140,000, and $5,316,000 in years 2002, 2001, and 2000, respectively. These expenses increased 15% in 2002 as compared to 2001 primarily as a result of additional marketing staff during 2002 and increased commission expense. The expense decrease of 3% in 2001 as compared to

2000 was primarily as a result of less expenditures on bid and proposal activities. In 2000, bid and proposal expenditures included significant activities on several large turnkey proposals.

Research and Development (R&D) costs were $368,000, $421,000, and $625,000 in years 2002, 2001, and 2000, respectively, and were primarily related to activities to enhance the capabilities of the ASE2000 Computer Data Acquisition System. This activity will continue into 2003, which management believes will further improve the marketability of the system. The reduction from 2001 is related to fewer active R&D programs in 2002. The reduction in 2001 from 2000 is also related to fewer active R&D programs in 2001.

Interest expense was $278,000, $721,000, and $574,000 in years 2002, 2001, and 2000, respectively. The major items bearing interest expense are the line of credit and borrowings from related parties. The average outstanding borrowings on the line of credit were $420,000 and $5,830,000 during 2002 and 2001, respectively. The decrease in borrowings from 2001 to 2002 is mostly due to the Company's ability to resume normal invoicing activities on the Singapore wind tunnel project after the receipt of the export license. On the line of credit, the weighted average interest rate for 2002 was 4.75% compared to 8.7% in 2001. The increase in interest expense from 2000 to 2001 reflects the increased borrowings during 2001 due to the impact of the delay of the receipt of the export license for the wind tunnel project in Singapore thereby delaying milestone invoicing activities. The weighted average interest rate for 2001 was 8.7% on the line of credit compared to 10.6% in 2000.

The Company recorded income tax expense of $479,000 in 2002, as compared to $152,000 in 2001 and $6,000 in 2000. Through September 25, 2001, the Company was included in the consolidated federal income tax return of Celsius Inc. The Company's income tax provision was calculated and presented on a separate return basis. Upon the closing of the acquisition of 51% of the Company's stock by Minnesota ASE, LLC, Celsius Inc. owned less than 80% of the Company and, accordingly, no longer included the Company in its consolidated federal income tax return. In the third quarter of 2001, in conjunction with that transaction, the Company recorded a noncash charge of $100,000 to reduce its income tax receivable from Celsius Inc. as a result of the termination of the tax sharing agreement. Also, as a part of the termination of the federal tax agreement with Celsius Inc., the Company and Celsius Inc. agreed to prorate the total 2001 federal tax liability based on the relative time periods of ownership during 2001, which reduced the Company's current income tax expense. During the fourth quarter of 2002, the Company reversed previously established tax valuation allowances of $546,000, as management concluded that certain tax assets were realizable. This was a non-cash transaction.

The Company recorded net income of $2,360,000, $271,000, and $331,000 in 2002, 2001, and 2000, respectively. The increase from 2001 was due to the increased business level and reduced interest expense as a result of reduced debt levels and lower interest rates. The reduction in net income in 2001 from 2000 was due to the increase in income tax expense relating to the termination of the federal income tax allocation agreement between the Company and Celsius Inc., which was terminated at the time of the sale on September 25, 2001.

Liquidity and Capital Resources - To minimize working capital requirements, the Company attempts to match receipt of contract installment payments with related contract expenditures. The Company's current ratio was 1.4 as of December 31, 2002, 1.2 as of December 31, 2001, and 1.0 as of December 31, 2000. Working capital amounts were $5,071,000 as of December 31, 2002, $1,868,000 as of December 31, 2001, and $(463,000) as of December 31, 2000.

The December 31, 2002 accounts receivable balance was $6,672,000, an increase of $1,942,000, as compared to 2001's balance of $4,730,000. The increase in the accounts receivable balance for 2002 was due to the contractual timing of customer billings.

Accounts payable and accrued expenses amounts were $9,686,000 and $5,538,000 in 2002 and 2001, respectively. The 2002 increase is $4,148,000 or 75%, as compared to 2001. The increase from 2001 is due primarily to the timing of procurement activities for existing projects, of which a couple of the larger projects had moved into the procurement phase of the project schedule toward the end of the year.

Billings in excess of earnings were $3,431,000, an increase of $1,740,000 when compared to 2001's balance of $1,691,000. This increase is due primarily to the timing of billing milestones related to contracts. Billings are a function of contract terms and do not necessarily relate to the percentage of completion of a project.

The Company has relied upon bank credit lines during recent years as a source of its working capital resources and liquidity. On September 25, 2001, the Company entered into new financing arrangements to replace its former credit line.

The Company's new bank agreements, which expire in September 2003, are asset-based collateral arrangements, with the funds available under these agreements determined by the available securable assets at any point in time, up to a maximum of $6,000,000 in operating funds, and $3,000,000 of letter of credit funds. The average funds available and amounts outstanding on the operating line and letter of credit during the period ended December 31, 2002 were $420,000 outstanding on $3,200,000 available and $2,200,000 outstanding on $3,000,000 available, respectively. The Company will negotiate to extend the existing bank agreements before September 2003.

The bank agreement contains covenants that require the Company to maintain certain financial ratios. The Company has been in compliance since inception and remains in compliance with these covenants as of December 31, 2002.

The Company also obtained a $1,500,000 three-year term loan from Celsius Inc., which is due September 2004. The loan bears interest at 8% and is subordinated to debt issued under the banking agreement. This loan is collateralized by a third-party pledge by Minnesota ASE, LLC of the shares of ASE purchased by Minnesota ASE, LLC from Celsius Inc. Celsius Inc. has also agreed to continue to hold certain existing bank guarantees until maturity that were previously provided to certain of the Company's customers. The Company has provided an indemnification agreement to Celsius Inc. to secure Celsius Inc.'s interest in the above items.

At the end of 2002, the Company had notes payable balances of $500,000 current and $1,500,000 long term. The current notes payable balance of $500,000 consisted of $500,000 of interim loans provided by Minnesota ASE, LLC. The $500,000 note to Minnesota ASE, LLC is at 8% per year and is a demand note. The Company believes that its bank lines of credit and notes, along with cash flows from continuing operations, are expected to be adequate to meet cash requirements in 2003.

The tables below summarize the Company's existing contractual obligations and commercial commitments in existence at December 31, 2002.

CONTRACTUAL OBLIGATIONS	PAYMENTS DUE BY PERIOD TOTAL	LESS THAN 1 YEAR	1-3 YEARS	4-5 YEARS	AFTER 5 YEARS
Long-term debt	$1,500,000	$ --	$1,500,000	$ --	$ --
Capital lease obligations	219,584	129,052	70,090	20,442	--
Operating leases	109,007	49,156	59,508	343	--
Unconditional purchase obligations	--	--	--	--	--
Other long-term obligations	--	--	--	--	--
Total contractual cash obligations	$1,828,591	$ 178,208	$1,629,598	$ 20,785	$ --

Refer to footnote 5 for discussion about long-term debt and footnote 7 for discussion about lease obligations.

OTHER COMMERCIAL COMMITMENTS	TOTAL AMOUNTS COMMITTED	AMOUNT OF COMMITMENT EXPIRATION PER PERIOD LESS THAN 1 YEAR	1-3 YEARS	4-5 YEARS	OVER 5 YEARS
Lines of credit	$ --	$ --	$ --	$ --	$ --
Standby letters of credit	4,270,975	2,413,175	1,857,800	--	--
Guarantees	--	--	--	--	--
Standby repurchase obligations	--	--	--	--	--
Other commercial commitments	--	--	--	--	--
Total commercial commitments	$4,270,975	$2,413,175	$1,857,800	$ --	$ --

Refer to footnote 8 for discussion about contingencies and commitments.

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Capital expenditures, including amounts under capital leases, were $567,000, $475,000, and $655,000 in years 2002, 2001, and 2000, respectively. Most of the 2002 capital expenditures were used to update desktop and shop equipment and facility improvements.

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

During 2002, approximately 56% of revenues were from international projects. Substantially all of the contract amounts are payable in U.S. dollars. For those contracts that are denominated in foreign currencies, the Company has entered into forward exchange contracts with banks to minimize the risks associated with foreign currency exchange rates. During 2001 and 2000, approximately 52% and 46% of revenues respectively were from international projects. Substantially all of the contract amounts are payable in U.S. dollars.

ITEM 7A - QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

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

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

ITEM 8 - FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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Report of Independent Auditors

The Stockholders and Board of Directors
Aero Systems Engineering, Inc.

We have audited the accompanying balance sheets of Aero Systems Engineering, Inc. as of December 31, 2002 and 2001, and the related statements of earnings, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Aero Systems Engineering, Inc. at December 31, 2002 and 2001, and the results of its earnings and its cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States.

/s/ Ernst & Young LLP

Minneapolis, Minnesota
January 24, 2003

Aero Systems Engineering, Inc.

Balance Sheets

	DECEMBER 31 2002	2001
ASSETS		
Current assets:		
Cash and cash equivalents	$ 3,233,679	$ 96,939
Accounts receivable - billed contracts, net of allowances of $110,000 in 2002 and $50,000 in 2001, including retainages of $0 and $106,000 in 2002 and 2001	6,671,843	4,730,460
Costs and estimated earnings in excess of billings on uncompleted contracts	6,361,226	4,876,894
Inventories	1,203,706	1,220,933
Prepaid expenses and other, net	341,845	318,159
Deferred income taxes	997,619	--
Total current assets	18,809,918	11,243,385
Property, plant, and equipment, net	4,121,188	4,613,412
Total assets	$22,931,106	$15,856,797

	DECEMBER 31 2002	2001
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current maturities of capital lease obligations	$ 121,742	$ 145,552
Notes payable	--	1,700,000
Notes payable with related parties	500,000	300,000
Accounts payable:		
Trade	2,161,660	2,147,366
Related parties	30,000	47,667
Billings in excess of costs and estimated earnings on uncompleted contracts	3,430,826	1,691,447
Accrued warranty and losses	492,953	460,253
Accrued salaries and wages	1,134,954	866,204
Accrued job costs	4,437,398	1,240,828
Income tax payable	358,012	47,627
Other accrued liabilities	1,071,246	728,356
Total current liabilities	13,738,791	9,375,300
Capital lease obligations, less current maturities	82,020	109,755
Long-term debt with related parties	1,500,000	1,500,000
Deferred income taxes	378,480	--
Stockholders' equity:		
Common stock, $.20 par value:		
Authorized shares - 10,000,000		
Issued and outstanding shares - 4,401,625	880,325	880,325
Additional paid-in capital	900,292	900,292
Retained earnings	5,451,198	3,091,125
Total stockholders' equity	7,231,815	4,871,742
Total liabilities and stockholders' equity	$22,931,106	$15,856,797

See accompanying notes.

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Aero Systems Engineering, Inc.

Statements of Earnings

	YEAR ENDED DECEMBER 31 2002	2001	2000
Earned revenue	$ 40,856,807	$ 27,182,583	$ 30,646,114
Cost of earned revenue	31,512,251	20,415,764	23,799,532
Gross profit	9,344,556	6,766,819	6,846,582

Selling, general, and administrative expenses	5,916,328	5,140,256	5,315,851
Research and development	368,378	420,931	625,466
Operating profit	3,059,850	1,205,632	905,265
Other (income) expense:			
Interest income	(33,755)	(4,387)	(3,236)
Interest expense	277,544	721,105	574,053
Other	(22,824)	65,548	(2,815)
	220,965	782,266	568,002
Income before income taxes	2,838,885	423,366	337,263
Income tax expense	478,812	152,428	6,260
Net income	$ 2,360,073	$ 270,938	$ 331,003
Net income per common share	$ .54	$ .06	$ .08
Weighted average common shares outstanding	4,401,625	4,401,625	4,401,625

See accompanying notes.

Aero Systems Engineering, Inc.

Statements of Changes in Stockholders' Equity

	COMMON STOCK		ADDITIONAL PAID-IN	RETAINED
	SHARES	AMOUNT	CAPITAL	EARNINGS
Balance at December 31, 1999	4,401,625	$ 880,325	$ 900,292	$2,489,184
Net income	--	--	--	331,003
Balance at December 31, 2000	4,401,625	880,325	900,292	2,820,187
Net income	--	--	--	270,938
Balance at December 31, 2001	4,401,625	880,325	900,292	3,091,125
Net income				2,360,073
Balance at December 31, 2002	4,401,625	$ 880,325	$ 900,292	$5,451,198

See accompanying notes.

Aero Systems Engineering, Inc.

Statements of Cash Flows

	YEAR ENDED DECEMBER 31 2002	2001	2000
OPERATING ACTIVITIES			
Net income	$ 2,360,073	$ 270,938	$ 331,00
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	1,059,407	1,063,158	1,100,08
Deferred taxes	(619,139)	--	-
Changes in operating assets and liabilities:			
Accounts receivable	(1,941,383)	1,630,967	1,943,35
Costs and estimated earnings in excess of billings on uncompleted contracts	(1,484,332)	119,522	(480,78
Inventories	17,227	262,805	(392,67
Prepaid expenses and other, net	(23,686)	(182,035)	58,17
Accounts payable and accrued expenses	3,837,537	1,071,692	(1,984,75
Income tax payable	310,385	47,627	8,26
Billings in excess of costs and estimated earnings on uncompleted contracts	1,739,379	(369,259)	(3,177,71
Net cash provided by (used in) operating activities	5,255,468	3,915,415	(2,595,05
INVESTING ACTIVITIES			
Capital expenditures	(567,183)	(329,558)	(655,22
Net cash used in investing activities	(567,183)	(329,558)	(655,22
FINANCING ACTIVITIES			
Net (repayments) borrowings under line of credit agreements	(1,700,000)	(5,275,755)	3,328,80
Proceeds received from related parties	200,000	4,100,000	-
Principal payments on borrowings from related parties	--	(2,300,000)	-
Principal payments under capital lease obligations	(51,545)	(60,971)	(79,18
Net cash (used in) provided by financing activities	(1,551,545)	(3,536,726)	3,249,61
Net increase (decrease) in cash and cash equivalents	3,136,740	49,131	(66
Cash and cash equivalents at beginning of year	96,939	47,808	48,47
Cash and cash equivalents at end of year	$ 3,233,679	$ 96,939	$ 47,80
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION			
Cash paid during the year for:			
Interest	$ 277,544	$ 721,105	$ 574,05
Income taxes	$ 787,567	$ 8,300	$ 26

NON-CASH INVESTING AND FINANCING ACTIVITIES

Purchase of equipment under capital leases	$ --	$ 145,694	$ -

See accompanying notes.

Aero Systems Engineering, Inc.

Notes to Financial Statements

December 31, 2002

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

DESCRIPTION OF BUSINESS

The Company's major operations are in the design and manufacture of electronic, mechanical, and computerized engine and engine accessory test equipment and the design, equipping, and construction of engine test facilities, wind tunnels, and other aerodynamic test facilities. In addition, the Company provides aeropropulsion component testing and vehicle aerodynamic testing services. Minnesota ASE, LLC owns 51% of the Company. Celsius Inc. owns 29% of the Company. See Note 10.

CASH AND CASH EQUIVALENTS

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

USE OF ESTIMATES

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

REVENUE RECOGNITION

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

INVENTORIES

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

EARNINGS PER SHARE

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

WARRANTY POLICY

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

LONG-LIVED ASSETS

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

DEPRECIATION

Property, plant, and equipment are recorded at cost and depreciated over their estimated useful lives of three to 40 years using straight-line and accelerated methods. Depreciation expense includes the amortization of capital lease assets.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

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

Foreign currency contracts: The fair values of foreign currency contracts (used for hedging purposes) are estimated by obtaining quotes from banks.

INCOME TAXES

The Company accounts for income taxes under the liability method. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

DERIVATIVES AND HEDGING

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities, during the first quarter of 2001. In doing so, the Company did not incur any material transition adjustments.

The Company uses foreign currency forward exchange contracts to offset the effect of exchange rate fluctuations on certain foreign currency denominated contracts. All derivatives are recognized on the balance sheet at their fair value. The fair value of existing contracts is not material.

RECLASSIFICATION

Certain prior period amounts have been reclassified to conform to current period presentation.

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Aero Systems Engineering, Inc.

Notes to Financial Statements (continued)

2. CONTRACTS IN PROCESS

	YEAR ENDED DECEMBER 31	
	2002	2001
Costs incurred on uncompleted contracts	$42,710,435	$35,094,586
Estimated earnings thereon	8,903,346	12,635,018
Total billable on uncompleted contracts	51,613,781	47,729,604
Less billings applicable thereto	48,683,381	44,544,157
	$ 2,930,400	$ 3,185,447
Included in the accompanying balance sheet under the following captions:		
Costs and estimated earnings in excess of billings on uncompleted contracts	$ 6,361,226	$ 4,876,894
Billings in excess of costs and estimated earnings on uncompleted contracts	3,430,826	1,691,447
	$ 2,930,400	$ 3,185,447

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

CONCENTRATIONS OF CREDIT RISK

At December 31, 2002, the Company had certain concentrations of credit risk with approximately $2,850,624 of unbilled charges and approximately $1,577,380 of accounts receivable from two customers, which are partially secured by letters of credit.

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Aero Systems Engineering, Inc.

Notes to Financial Statements (continued)

3. INVENTORIES

Inventories consist of the following:

	DECEMBER 31 2002	DECEMBER 31 2001
Materials and supplies	$ 843,181	$ 965,594
Projects-in-process	360,525	255,339
	$ 1,203,706	$ 1,220,933

4. PROPERTY, PLANT, AND EQUIPMENT

	DECEMBER 31 2002	DECEMBER 31 2001
Land	$ 486,105	$ 486,105
Buildings	3,025,460	3,025,460
Furniture, fixtures, and equipment	9,037,999	8,648,346
Wind tunnels and instrumentation	3,226,459	3,130,182
Building improvements	1,569,780	1,488,527
	17,345,803	16,778,620
Less accumulated depreciation	(13,224,615)	(12,165,208)
Property, plant, and equipment, net	$ 4,121,188	$ 4,613,412

5. NOTES PAYABLE

On September 25, 2001, the Company entered into new financing arrangements to replace its former credit line. The Company's new bank agreements, which expire in September 2003, are asset-based collateral arrangements, with the funds available under these agreements determined by the available securable assets at any point in time, up to a maximum of $6,000,000 in operating funds and $3,000,000 of letter of credit funds. At December 31, 2002 and 2001, $-0- and $1,700,000 were outstanding under the operating funds and $2,351,000 and $1,300,000 under the letter of credit portions of the agreements, respectively.

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Aero Systems Engineering, Inc.

Notes to Financial Statements (continued)

5. NOTES PAYABLE (CONTINUED)

The bank agreement contains covenants that require the Company to maintain certain financial ratios. The Company is in compliance with these covenants since inception and remains in compliance with these covenants as of December 31, 2002.

The Company also obtained a $1,500,000 three-year term loan from Celsius Inc., which is due September 2004. The loan bears interest at 8% and is subordinated to debt issued under the banking agreement. This loan is collateralized by a third-party pledge by Minnesota ASE, LLC of the shares of ASE purchased by Minnesota ASE, LLC from Celsius Inc. Celsius Inc. has also agreed to continue to hold certain existing bank guarantees until maturity that were previously provided to certain of the Company's customers. The Company has provided an indemnification agreement to Celsius Inc. to secure Celsius Inc.'s interest in the above items.

On September 25, 2001, Minnesota ASE, LLC loaned the Company $2,600,000 in order to supplement bank financing. The maturity date was January 11, 2002 and the loan interest rate was equal to the bank's base rate plus .25%. The Company repaid $2,300,000 prior to December 31, 2001. The remaining $300,000 has been converted to a note bearing interest at 8% and does not have a stated due date. During 2002, Minnesota ASE, LLC loaned the Company an additional $200,000 to supplement bank financing in the form of a note bearing interest at 8% with no stated due date.

During 2002 and 2001, the average borrowings on bank lines of credit were $420,000 and $5,830,000, respectively, with weighted average interest rates during the year of 4.7% and 8.7%, respectively.

6. INCOME TAXES

During the fourth quarter of 2002, the Company reversed previously established tax valuation allowances of $546,000, as management concluded that certain tax assets were realizable. The remaining valuation allowance relates to the uncertain realizability of the net state tax operating loss carryforward and state tax credits due to imminent expiration dates and limitations under Section 382 of the Internal Revenue Code due to changes in ownership.

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Aero Systems Engineering, Inc.

Notes to Financial Statements (continued)

6. INCOME TAXES (CONTINUED)

Through September 25, 2001, the Company was included in the consolidated federal income tax return of Celsius Inc. The Company's income tax provision was calculated and presented on a separate return basis. Upon the closing of the acquisition of 51% of the Company's stock by Minnesota ASE, LLC, Celsius Inc. owned less than 80% of the Company and, accordingly, no longer includes the Company in its consolidated federal income tax return. In the third quarter of 2001, in conjunction with that transaction, the Company recorded income tax expense of $100,000 to reduce its income tax receivable from Celsius Inc. as a result of the termination of the tax sharing agreement. Also, as a part of the termination of the federal tax sharing agreement with Celsius Inc., the Company and Celsius Inc. agreed to prorate the total 2001 federal tax liability based on the relative time periods of ownership during 2001.

The components of income tax expense for the years ended December 31 are:

	2002	2001	2000
Current	$ 1,098,000	$ 152,000	$ 18,000
Deferred	(619,000)	--	(12,000)
	$ 479,000	$ 152,000	$ 6,000

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

	YEAR ENDED DECEMBER 31		
	2002	2001	2000
Income taxes at 34%	$ 965,000	$ 144,000	$ 115,000
State taxes, net of federal benefit	8,000	7,000	4,000
Effect of net operating loss carryforward and valuation allowance	(546,000)	(101,000)	(118,000)
Termination of tax sharing agreement	--	100,000	--
Other	52,000	2,000	5,000
	$ 479,000	$ 152,000	$ 6,000

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Aero Systems Engineering, Inc.

Notes to Financial Statements (continued)

6. INCOME TAXES (CONTINUED)

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

	DECEMBER 31 2002	DECEMBER 31 2001
Current deferred tax assets (liabilities):		
Contract-related costs	$ 345,000	$ 352,000
Warranty costs	144,000	148,000
Vacation accrual	216,000	180,000
Inventory and receivable reserves	315,000	286,000
Net operating loss carryforward	19,000	37,000
Other	(30,000)	(5,000)
Tax credit carryforwards	101,000	108,000
Total current deferred tax assets	1,110,000	1,106,000
Noncurrent deferred tax liabilities:		
Tax over book depreciation	379,000	448,000
Total deferred tax liabilities	379,000	448,000
Net deferred tax asset	731,000	658,000
Valuation allowance	(112,000)	(658,000)
Net deferred taxes	$ 619,000	$ --

The Company also has a net state tax operating loss carryforward of approximately $943,000 which will expire beginning in the year 2008 to the extent not utilized.

7. LEASE OBLIGATIONS

The Company has capitalized leases for facilities and equipment which expire through 2006. The capitalized cost at December 31, 2002 and 2001 was $986,577 less accumulated amortization of $775,994 and $666,162, respectively. Amortization on capital leases is recorded as part of depreciation expense.

The Company also has a number of operating lease agreements primarily involving manufacturing and warehouse space and office equipment, which expire on various dates through 2007. Total rental expense under operating leases for occupancy and equipment was approximately $103,000, $160,000, and $217,000, for 2002, 2001, and 2000, respectively.

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Aero Systems Engineering, Inc.

Notes to Financial Statements (continued)

7. LEASE OBLIGATIONS (CONTINUED)

Following is a schedule of future minimum lease payments:

	CAPITAL LEASES	OPERATING LEASES

Year ending December 31:		
2003	$129,052	$ 49,156
2004	35,045	34,257
2005	35,045	21,135
2006	20,442	4,116
2007	--	343
Total minimum lease payments	219,584	$109,007
Less amount representing interest	15,822	
Present value	203,762	
Less principal amount due currently	121,742	
	$ 82,020	

Included in the $129,052 capital lease payment in 2003 is the $95,000 purchase option payment to the Port Authority of Saint Paul for the 181 East Florida Street facility.

8. CONTINGENCIES AND COMMITMENTS

Guarantees of approximately $4,270,975 were outstanding at December 31, 2002 to various customers as bid bonds or in exchange for down payments or warranty performance bonds.

9. RETIREMENT SAVINGS PLAN

The Company has a Retirement Savings Plan (the Plan) which qualifies under Section 401(k) of the Internal Revenue Code and covers all employees. Members of the Plan who have completed at least 12 consecutive months of service, during which they have worked at least 1,000 hours, are eligible for the employer matching contribution. Contributions up to 6% of the employees' compensation are matched at a rate of 50% by the Company. Company contributions to the Plan for the years ended December 31, 2002, 2001, and 2000 were $282,000, $260,000, and $269,000, respectively.

10. RELATED-PARTY TRANSACTIONS

On September 25, 2001, Minnesota ASE, LLC acquired 2,245,000 shares of common stock of Aero Systems Engineering, Inc. from Celsius Inc., a subsidiary of Saab AB, representing 51% of the outstanding shares. Celsius Inc. retains a 29% stock interest in the Company. See Note 5 for a description of related party financing arrangements.

Through September 25, 2001, Celsius Inc. and its affiliated companies and, after September 25, 2001, Minnesota ASE, LLC, provided certain administrative support services to the Company, and the Company is charged a fee for such services.

Such fees with affiliates are summarized as follows:

	YEAR ENDED DECEMBER 31		
	2002	2001	2000
Interest expense	$ 39,000	$137,000	$150,000
Administrative charges	141,000	63,000	50,000

11. SEGMENT INFORMATION

The Company operates primarily in one business segment relating to engine and aerodynamic test facilities. The Company's operations are structured to achieve maximum overall corporate objectives. As a result, significant inter-dependencies and overlaps exist among the Company's operating units.

Revenues by geographic area are summarized as follows:

	2002	2001	2000
United States	$17,948,724	$12,956,374	$16,578,706
Foreign countries	22,908,083	14,226,209	14,067,408
	$40,856,807	$27,182,583	$30,646,114

Aero Systems Engineering, Inc.

Notes to Financial Statements (continued)

11. SEGMENT INFORMATION (CONTINUED)

The Company had three customers accounting for 20%, 19%, and 10% of revenues during the year ended December 31, 2002, three customers accounting for 36%, 19%, and 11% of revenues in the year ended December 31, 2001, and three customers accounting for 28%, 23%, and 15% of sales in the year ended December 31, 2000.

12. QUARTERLY RESULTS (UNAUDITED)

Summary data relating to the results of operations for each quarter of the years ended December 31, 2002 and 2001 are as follows:

	THREE MONTHS ENDED			
	MARCH 31	JUNE 30	SEPTEMBER 30	DECEMBER 31
2002				
Earned revenue	$ 8,927,000	$ 10,973,000	$ 9,442,000	$ 11,515,000
Gross profit	1,811,000	2,453,000	2,031,000	3,050,000
Net income	193,000	525,000	408,000	1,234,000

Net income per common share	$ .04	$ .12	$ .09	$ .28
2001				
Earned revenue	$ 5,739,000	$ 6,093,000	$ 5,709,000	$ 9,642,000
Gross profit	1,343,000	1,646,000	1,684,000	2,094,000
Net (loss) income	(283,000)	(96,000)	7,000	643,000
Net (loss) income per common share	$ (.06)	$ (.02)	$ .00	$ .14

12. QUARTERLY RESULTS (UNAUDITED) (CONTINUED)

In the fourth quarter of 2002, the Company reversed previously established tax valuation allowances of $546,000, as management concluded that certain tax assets were realizable. See Note 6.

The increase in revenue and income during the fourth quarter of 2001 was due to the resumption of normal activities on the Singapore wind tunnel project after the receipt of the export license and to the fact that several other new projects achieved the 10% revenue and margin recognition threshold during the quarter.

Third quarter 2001 includes income tax expense of $100,000 related to termination of the tax allocation agreement. See Note 6.

ITEM 9 - CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10 through ITEM 13

Items 10 through 13 of this Annual Report on Form 10-K are omitted because the Company intends to file on or before April 25, 2003 a definitive proxy statement conforming to Schedule 14A involving the election of directors. Certain information set forth in such proxy statement is hereby incorporated by reference into this Annual Report on Form 10-K as Items 10, 11, 12, and 13 of Part III.

ITEM 14 - CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures - The term "disclosure controls and procedures" is defined in Rules 13a-14(c) and 15d-14(c) of the Securities Exchange Act of 1934 (Exchange Act). These rules refer to the controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized, and reported within required time periods. The Company's Chief Executive Officer and the Company's Chief Financial Officer have evaluated the effectiveness of the disclosure controls and procedures as of a date within 90 days before filing this annual report (the Evaluation Date), and they have concluded that, as of the Evaluation Date, such controls and procedures were effective at ensuring that required information will be disclosed on a timely basis in our reports filed under the Exchange Act.

Changes in Internal Control - We maintain a system of internal accounting controls that are designed to provide reasonable assurances that our books and records accurately reflect our transactions and that our established policies and procedures are followed. For the period ended December 31, 2002, there were no significant changes to our internal controls or in other factors that could significantly affect our internal controls.

PART IV

ITEM 15 - EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a)1. Financial Statements

The financial statements and notes thereto are set forth in the Index to Financial Statements filed as Item 8 to this Annual Report on Form 10-K.

(a)2. Financial Statement Schedules

All schedules have been omitted, as the required information is not present or not present in amounts sufficient to require submission of the schedules or because the information required is included in the financial statements or notes thereto.

(a)3. Exhibits

Exhibits 99.1 (Certification of Chief Financial Officer) and 99.2 (Certification of Chief Executive Officer).

(b)3. Reports on Form 8-K

On October 17, 2002, the registrant filed a Form 8-K report to announce an agreement with Goldsmith Agio Helms to assist the Company in exploring strategic alternatives.

On February 4, 2003, the registrant filed a Form 8-K report to file a press release announcing the year end 2002 financial results.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Aero Systems Engineering, Inc.

(Registrant)

March 12, 2003	By /s/ Charles H. Loux
Date	Charles H. Loux, President and Chief Executive Officer
March 12, 2003	By /s/ Steven R. Hedberg
Date	Steven R. Hedberg, Chief Financial Officer

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

March 12, 2003	/s/ Charles H. Loux
Date	Charles H. Loux, President and Chief Executive Officer, Director
March 12, 2003	/s/ Richard A. Hoel
Date	Richard A. Hoel, Chairman of the Board
March 12, 2003	/s/ A. L. Maxson
Date	A. L. Maxson, Director
March 12, 2003	/s/ Dr. Leon E. Ring
Date	Dr. Leon Ring, Director
March 12, 2003	/s/ James S. Kowalski
Date	James S. Kowalski, Director

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March 12, 2003	/s/ Thomas L. Auth
Date	Thomas L. Auth, Director
March 12, 2003	/s/ Mark D. Pugliese
Date	Mark D. Pugliese, Director
March 12, 2003	/s/ Patrick J. Donovan
Date	Patrick J. Donovan, Director

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CERTIFICATIONS

I, Charles H. Loux, certify that:

1. I have reviewed this annual report on Form 10-K of Aero Systems Engineering, Inc.;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

   c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize, and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 4, 2003

Aero Systems Engineering, Inc.

By: /s/ Charles H. Loux

Charles H. Loux
President and CEO

CERTIFICATIONS

I, Steven R. Hedberg, certify that:

1. I have reviewed this annual report on Form 10-K of Aero Systems Engineering, Inc.;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

   c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize, and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

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6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 4, 2003

Aero Systems Engineering, Inc.

By: /s/ Steven R. Hedberg

Steven R. Hedberg
CFO, Secretary and Treasurer

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