AEROSONIC CORP /DE/
Form 10-Q
June 16, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934.**
For the quarterly period ended May 2, 2008

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from __________ to __________

Commission file number 1-11750

AEROSONIC CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**74-1668471**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

1212 North Hercules Avenue

Clearwater, Florida 33765

(Address of principal executive offices and Zip Code)

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

Not Applicable

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

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

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

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company x

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

As of May 30, 2008, the issuer had 3,580,901 shares of common stock outstanding, net of treasury shares.

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PART I - FINANCIAL INFORMATION

Cautionary Note on Forward-Looking Statements

Certain statements made in this Quarterly Report on Form 10-Q that are not statements of historical or current facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements may involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from historical results or from any future results expressed or implied by such forward-looking statements.

In addition to statements that explicitly describe such risks and uncertainties, readers are urged to consider statements in future or conditional tenses or, include terms such as believes, belief, expects, intends, anticipates or plans to be uncertain and forward-looking. Forward-looki statements are based on management s beliefs and assumptions, using information currently available to us as to current expectations concerning future events and trends and are necessarily subject to uncertainties, many of which are outside of the Company s control. You should specifically consider the factors identified in Part II Item 1A. RISK FACTORS of this Quarterly Report on Form 10-Q, which could cause actual results to differ from those referred to in forward-looking statements.

We claim the protection of the safe harbor for forward-looking statements provided for in the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934 (the Exchange Act), as amended. Except as required by applicable law, we undertake no obligation, and do not intend, to update these forward-looking statements to reflect events or circumstances that arise after the date they are made. Furthermore, as a matter of policy, we do not generally make any specific projections as to future earnings, nor do we endorse any projections regarding future performance, which may be made by others outside our Company.

All subsequent written and oral forward-looking statements attributable to the Company or individuals acting on its behalf are expressly qualified in their entirety by this Cautionary Note on Forward-Looking Statements.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

AEROSONIC CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (Unaudited)

	May 2, 2008	January 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 95,000	$ 28,000
Accounts receivable, net of allowance for doubtful accounts of $202,000 and $131,000, respectively	4,733,000	4,593,000
Income taxes receivable	4,000	29,000
Inventories, net	7,711,000	7,760,000
Prepaid expenses	217,000	154,000
Property held for sale, net	1,712,000	1,712,000
Deferred income taxes	1,084,000	1,151,000
Total current assets	15,556,000	15,427,000
Property, plant and equipment, net	1,995,000	2,127,000
Deferred income taxes	2,670,000	2,479,000
Intangible assets, net	833,000	888,000
Goodwill	366,000	366,000
Other assets, net	87,000	93,000
Total assets	$ 21,507,000	$ 21,380,000
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current maturities of long-term debt and notes payable	$ 5,726,000	$ 5,814,000
Accounts payable, trade	3,007,000	3,107,000
Revolving credit facility	2,183,000	1,514,000
Compensation and benefits	791,000	956,000
Accrued sales commissions	243,000	242,000
Accrued expenses and other liabilities	1,402,000	1,364,000
Total current liabilities	13,352,000	12,997,000
Unrecognized tax benefits	258,000	258,000
Deferred income taxes	311,000	331,000
Total liabilities	13,921,000	13,586,000
Commitments and contingencies (Note 8)		
Stockholders equity:		
Common stock, $.40 par value; authorized 8,000,000 shares; issued 4,011,668 shares at May 2, 2008 and 4,008,053 shares at January 31, 2008; outstanding 3,580,901 shares at May 2, 2008 and 3,577,286 at January 31, 2008	1,606,000	1,605,000
Additional paid-in capital	4,844,000	4,817,000
Retained earnings	4,299,000	4,535,000
Less treasury stock: 430,767 shares at both May 2, 2008 and January 31, 2008, at cost	(3,163,000)	(3,163,000)

Total stockholders equity	7,586,000	7,794,000
Total liabilities and stockholders equity	$ 21,507,000	$ 21,380,000

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

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AEROSONIC CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

	Three Months Ended	
	May 2, 2008	**April 27, 2007**
Revenues	$ 6,651,000	$ 6,825,000
Cost of sales	5,248,000	5,050,000
Gross profit	1,403,000	1,775,000
Selling, general and administrative expenses	1,637,000	1,861,000
Gain on sale of property, plant and equipment	2,000	264,000
Operating income (loss)	(232,000)	178,000
Other income (expense):		
Interest expense, net	(156,000)	(40,000)
Other income	8,000	
	(148,000)	(40,000)
Income (loss) before income taxes	(380,000)	138,000
Income tax benefit (expense)	144,000	(76,000)
Net income (loss)	$ (236,000)	$ 62,000
Basic and diluted earnings (loss) per share	$ (0.07)	$ 0.02

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

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AEROSONIC CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	Three Months Ended	
	May 2, 2008	**April 27, 2007**
Cash flows from operating activities:		
Net income (loss)	$ (236,000)	$ 62,000
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation	112,000	127,000
Amortization	61,000	6,000
Bad debt expense	100,000	
Stock-based compensation	28,000	12,000
Gain on sale of property, plant and equipment	(2,000)	(264,000)
Deferred income taxes	(144,000)	
Changes in operating assets and liabilities:		
Accounts receivable, net	(240,000)	972,000
Income taxes receivable	25,000	40,000
Inventories, net	49,000	56,000
Prepaid expenses	(63,000)	(3,000)
Other assets		(5,000)
Accounts payable, trade	(100,000)	207,000
Compensation and benefits	(165,000)	(78,000)
Accrued sales commissions	1,000	
Accrued expenses and other liabilities	38,000	(106,000)
Net cash provided by (used in) operating activities	(536,000)	1,026,000
Cash flows from investing activities:		
Proceeds from the sale of property	22,000	385,000
Purchases of property, plant and equipment		(49,000)
Net cash provided by investing activities	22,000	336,000
Cash flows from financing activities:		
Net increase in revolving credit facility	669,000	
Principal payments on current maturities of long-term debt and notes payable	(88,000)	(60,000)
Net cash provided by (used in) financing activities	581,000	(60,000)
Change in cash and cash equivalents	67,000	1,302,000
Cash and cash equivalents, beginning of period	28,000	1,276,000
Cash and cash equivalents, end of period	$ 95,000	$ 2,578,000
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	$ 156,000	$ 40,000
Income taxes	$	$ 40,000

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

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AEROSONIC CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1. Description of Business, Basis of Presentation and Recent Accounting Pronouncements

Description of Business

The primary business of Aerosonic Corporation and subsidiaries (the **Company**) is to manufacture and sell aircraft instrumentation to government and commercial users from its facilities located in Florida and Virginia. The Company s customers are located worldwide.

On August 21, 2007, the Company purchased 100% of the outstanding stock of OP Technologies, Inc. (**OP Tech**), an Oregon-based developer and manufacturer of cockpit glass display solutions.

Financial Condition and Management s Plans

As of both May 2, 2008 and January 31, 2008 we were not in compliance with certain debt covenants with our lender and consequently, all of our debt with our lender is classified as current in our consolidated balance sheets at both May 2, 2008 and January 31, 2008. We currently have a written waiver through June 30, 2008 relating to our noncompliance and are currently in negotiations with our lender. We expect to renegotiate our debt agreements to ensure compliance throughout fiscal year 2009. If we do not renegotiate such agreements and are not in compliance with such agreements, our lender may accelerate the maturity of the notes. Based upon an analysis of our contracts in place and our current backlog, we believe we will be able to generate sufficient cash flows to fund our operating needs through the remainder of fiscal 2009. If certain of these events do not materialize, we believe other alternatives exist to meet our cash requirements. Although we have challenges ahead of us, we believe our current plans will allow us to improve our operational performance for the fiscal year 2009.

Basis of Presentation

The Company prepares its consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (**U.S. GAAP**) for interim financial information and are presented in accordance with the requirements of Form 10-Q and therefore do not include all the information and notes necessary for a fair presentation of financial position, results of operations and cash flow in conformity with U.S. GAAP. These principles require management to make estimates and judgments that affect reported and contingent amounts of assets, liabilities, revenues and expenses, including such items as (i) inventory, restructuring and environmental costs, (ii) percentage-of-completion estimates, (iii) other miscellaneous accruals and (iv) valuation allowances for accounts receivable, inventory and deferred tax assets. Actual results may differ from these estimates under different assumptions or conditions, and such differences could be material.

The accompanying consolidated financial statements include the accounts of Aerosonic Corporation and its wholly-owned subsidiaries, Avionics Specialties, Inc. (**Avionics**) and OP Tech (since the date of acquisition). All significant intercompany balances and transactions have been eliminated in consolidation. The Company operates on a fiscal year that ends on January 31. Accordingly, all references to the first quarter mean the first quarter ended on the last Friday of April or the first Friday of May of the referenced fiscal year. For example, references to the first quarter of fiscal year 2009 mean the quarter ended May 2, 2008.

These financial statements are prepared on a basis consistent with, and should be read in conjunction with, the consolidated financial statements and related notes contained in the Annual Report on Form 10-K for the fiscal year ended January 31, 2008. Operating results for the three months ended May 2, 2008 are not necessarily indicative of the results that may be expected for the year ending January 31, 2009.

Recent Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board (**FASB**) issued Statement of Financial Accounting Standards (**SFAS**) No. 159, *The Fair Value Option for Financial Assets and Liabilities* (**SFAS 159**). SFAS 159 permits companies to make an election to carry certain eligible financial assets and liabilities at fair value, even if fair value measurement has not historically been required for such assets and liabilities under U.S. GAAP. Effective February 1, 2008, the Company did not elect the fair value option for any instruments.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (**SFAS 157**). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with U.S. GAAP, and expands disclosures about fair value measurements. The Company was required to adopt the provisions of SFAS 157 in the first quarter of the fiscal year beginning February 1, 2008. The adoption of SFAS 157 had no effect on the Company s consolidated financial statements.

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In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations A Replacement of FASB Statement No. 141* (**SFAS 141(R)**). SFAS 141(R) retains the fundamental requirements in SFAS No. 141, *Business Combinations (* **SFAS 141** *),* that the acquisition method of accounting *(*which SFAS 141 called the *purchase method)* be used for all business combinations and that an acquirer be identified for each business combination. It also retains the guidance in SFAS 141 for identifying and recognizing intangible assets separately from goodwill. However, SFAS 141(R) will change the accounting treatment for certain specific items, including:

- All business combinations (whether full, partial, or step acquisitions) will result in all assets and liabilities of an acquired business being recorded at fair value, with limited exceptions;
- Acquisition costs will be generally expensed as incurred;
- The fair value of the purchase price, including the issuance of equity securities, will be determined on the acquisition date;
- Purchases or sales of equity interests that do not result in a change in control will be accounted for as equity transactions. Upon a loss of control, the interest sold, as well as any interest retained, will be measured at fair value, with any gain or loss recognized in earnings;
- Non-controlling interests (formerly known as minority interests) will be valued at fair value at the acquisition date;
- Certain acquired contingent liabilities will be recorded at fair value at the acquisition date and subsequently measured at either the higher of such amount or the amount determined under existing guidance for non-acquired contingencies;
- Restructuring costs associated with a business combination will be generally expensed subsequent to the acquisition date; and
- Changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date generally will affect income tax expense.

SFAS 141(R) also includes a substantial number of new disclosure requirements. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. SFAS 141(R) will have an effect on the Company s future acquisitions.

Note 2. Accounts Receivable

The Company s allowance for doubtful accounts activity for the three months ended May 2, 2008 and April 27, 2007 was as follows:

	Three Months Ended,	
	May 2, 2008	**April 27, 2007**
Beginning balance	$ 131,000	$ 10,000
Amounts written off	(29,000)	
Amounts provided for	100,000	
Ending balance	$ 202,000	$ 10,000

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Note 3. Inventories

Inventories at May 2, 2008 and January 31, 2008 consisted of the following:

	May 2, 2008	January 31, 2008
Raw materials	$ 6,407,000	$ 6,414,000
Work in process	1,981,000	2,070,000
Finished goods	158,000	153,000
Reserve for obsolete and slow moving inventory	(835,000)	(877,000)
Inventories, net	$ 7,711,000	$ 7,760,000

The reserve for obsolete and slow moving inventory activity for the three months ended May 2, 2008 and April 27, 2007 was as follows:

	Three Months Ended,	
	May 2, 2008	April 27, 2007
Beginning balance	$ 877,000	$ 618,000
Amounts charged (credited) to operations	(42,000)	42,000
Ending balance	$ 835,000	$ 660,000

Note 4. Intangible Assets

Amortization expense related to intangible assets for the three months ended May 2, 2008 was $55,000. Since these intangible assets were acquired during fiscal year 2008, there was no amortization expense related to intangible assets for the three months ended April 27, 2007. Amortization expense for the three months ended April 27, 2007 of $6,000 related to capitalized bond issue costs.

Note 5. Accrued Expenses and Other Liabilities

Accrued expenses and other liabilities as of May 2, 2008 and January 31, 2008 consisted of the following:

	May 2, 2008	January 31, 2008
Environmental liability	$ 549,000	$ 639,000
Warranty liability	212,000	197,000
Product development programs	141,000	141,000
Other	500,000	387,000
Accrued expenses and other liabilities	$ 1,402,000	$ 1,364,000

On March 9, 2007, the Company announced the consolidation of the manufacturing functions of its Earlysville, Virginia, operation into its Clearwater, Florida facility. This consolidation was a continuation of the Company s actions to be more responsive to customers demands and the majority of the consolidation was primarily completed in fiscal year 2008. Restructuring costs of $66,000 and $282,000 are included in selling, general and administrative expenses for the three months ended May 2, 2008 and April 27, 2007, respectively. Approximately $35,000 remains to be paid as of May 2, 2008 and is included in the line item Other in the preceding table.

Note 6. Long-Term Debt and Notes Payable and Revolving Credit Facility

The Company s credit facilities are with Wachovia Bank, N.A. (**Wachovia**). In fiscal year 2008, the Company increased the maximum amount available to the Company under its credit facilities with Wachovia to $8,420,000 and delivered to Wachovia two replacement promissory notes as follows: (i) a Renewal and Future Advance Promissory Note in the amount of $3,920,000 (the **Future Advance Note**), and (ii) a Renewal and Amended Term Promissory Note in the amount of $2,000,000 (the **Term Note** and together with the Future Advance Note, the **Notes**). The Future Advance Note is collateralized by the Company s real estate in Clearwater, Florida. The Term Note is collateralized by the Company s real

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estate in Earlysville, Virginia. The interest rate on the revolving credit facility as well as on the Notes is one-month LIBOR (which was 2.67% and 3.27% at May 2, 2008 and January 31, 2008, respectively), plus 300 basis points. Total available borrowings on the revolving credit facility at May 2, 2008 and January 31, 2008 including amounts borrowed as of those dates were $2,210,000 and $1,762,000, respectively.

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

As of both May 2, 2008 and January 31, 2008, the Company was not in compliance with the cash flow coverage ratio covenant and the total liability to tangible net worth covenant. Wachovia has provided a written waiver of the non-compliance to the Company through June 30, 2008. If we do not renegotiate such agreements and are not in compliance with such agreements, our lender may accelerate the maturity of the notes. Consequently, the entire amount of long-term debt is classified as a current maturity at both May 2, 2008 and January 31, 2008.

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

Long-term debt and notes payable at May 2, 2008 and January 31, 2008 consisted of the following:

	May 2, 2008	January 31, 2008
Future Advance Promissory Note	$ 3,728,000	$ 3,816,000
Term Promissory Note	1,998,000	1,998,000
	5,726,000	5,814,000
Less: current maturities	(5,726,000)	(5,814,000)
Long-term debt and notes payable, less current maturities	$	$

Interest expense on long-term debt, notes payable and the revolving credit facility for the three months ended May 2, 2008 and April 27, 2007 was $156,000 and $40,000, respectively

Note 7. Stockholders Equity

Earnings (Loss) Per Share

Basic earnings per share are based upon the Company s weighted average number of common shares outstanding during each period. Diluted earnings per share are based upon the weighted average number of common shares outstanding during each period, assuming the issuance of common shares for all dilutive potential common shares outstanding during the period, using the treasury stock method. Potential common stock shares resulting from stock options were not included in the computation of diluted earnings (loss) per share for the three months ended May 2, 2008 because the inclusion of the potential common stock would be anti-dilutive since the Company is in a net loss position and including such shares would reduce the net loss per share.

	Three Months Ended,	
	May 2, 2008	April 27, 2007
Weighted average shares outstanding basic	3,580,901	3,567,515
Dilutive effect of stock options		12,177
Weighted average shares outstanding diluted	3,580,901	3,579,692

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Options to Purchase Stock

On April 22, 2008, the Company issued to its President and Chief Executive Officer and to its Executive Vice President of Sales and Marketing, options to purchase 75,000 shares each of the Company s common stock at the common stock s market price on that day. These options vest from one to three years and from one to four years, respectively, from the date of grant.

Stock-Based Compensation

For the three months ended May 2, 2008 and April 27, 2007, total equity-based compensation of approximately of $28,000 and $12,000, respectively, related to stock options previously granted was included in selling, general and administrative expenses.

Note 8. Commitments and Contingencies

Litigation

From time to time, the Company may be involved in certain claims and legal actions arising in the ordinary course of business. As of May 2, 2008, there were no claims or legal actions that we believe will have a material adverse effect on the Company s financial position, results of operations, or liquidity.

Environmental

In preparation for the sale of the Earlysville, Virginia facility, the Company engaged an environmental consulting firm to survey the property for possible soil or groundwater contamination. This survey revealed impacts to both shallow soils and groundwater that may have resulted from the accidental loss of solvents. As a result of the initial and subsequent surveys, contamination treatment was determined to be necessary for an estimated total cost of $588,000, as determined by an environmental compliance specialist, and which is included in the environmental liability. Thus, in accordance with Emerging Issues Task Force 90-8, *Capitalization of Costs to Treat Environmental Contamination,* the Company has capitalized these contamination treatment costs in its fiscal year 2008 financial statements as an increase to property held for sale, net, since such costs will be incurred in preparation for the sale of the Earlysville, Virginia facility.

Commitments

There have been no material changes to our purchase and lease commitments from those disclosed in our Annual Report on Form 10-K for the year ended January 31, 2008. Total rent expense under the facility lease near Earlysville, Virginia for the three months ended May 2, 2008 and April 27, 2007 was $39,000 and $0, respectively, which is included in cost of sales.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS (MD&A)

Results of Operations

Sales for the first quarter of fiscal year 2009 decreased approximately $174,000, or 3%, when compared to the first fiscal quarter of 2008. The decrease in sales was driven primarily by continuing operating inefficiencies associated with the relocation, consolidation and integration of previously decentralized operations in Earlysville, Virginia, making it difficult to fill existing sales orders on a timely basis.

Cost of sales for the first fiscal quarter of 2009 increased by $198,000, or 4%, to $5,248,000 when compared to $5,050,000 for the first fiscal quarter of 2008. Gross margin decreased from 26% for the first fiscal quarter of 2008 to 21% for the first fiscal quarter of 2009.

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The decline in gross margin as a percentage of revenue is due to the following:

- an increase in material and labor costs, much of which relates to productivity and production challenges we continued to experience in the first fiscal quarter of 2009;
- short term operating inefficiencies associated with the relocation, consolidation and integration of previously decentralized operations;
- constraints on price brought about by fixed income contracts; and
- a highly competitive market.

Improving gross margin will require the following:

- improving controls over the manufacturing process;
- planning inventory purchases and movement carefully; and
- reducing costs and inefficiencies in our operations through better resource management and improved accountability.

These initiatives will be complimented with a marketing and sales strategy that addresses the highly competitive environment.

Selling, general and administrative expenses for the first fiscal quarter of 2009 decreased $224,000 when compared to the first fiscal quarter of 2008. This decrease was attributable to the benefits of consolidating our Earlysville, Virginia operations with our Clearwater, Florida operations, which began and was primarily completed during fiscal year 2008.

Interest expense, net increased approximately $116,000 for the first fiscal quarter of 2009 when compared to the first fiscal quarter of 2008. This decrease is a function of larger average balances outstanding on our credit facilities.

The first fiscal quarter of 2008 operating results included a gain on sale of property, plant and equipment of $264,000. This gain was due to the sale of our Wichita, Kansas property as well as the sale during the first fiscal quarter of 2008 of certain machinery and equipment that was no longer required for operations.

Income tax expense decreased approximately $220,000 for the first fiscal quarter of 2009 when compared to the first fiscal quarter of 2008. This decrease was primarily due to operating losses incurred in the first fiscal quarter of 2009.

Liquidity and Capital Resources

Cash used in operating activities was approximately $536,000 for the first fiscal quarter of 2009, a decrease in cash provided of approximately $1,562,000 when compared to the first fiscal quarter of 2008. This increase in cash used is primarily attributable to continuing losses from operations.

Cash provided by investing activities for first fiscal quarter of 2009 and the first fiscal quarter of 2008 consisted primarily of proceeds from the sale of property.

Cash provided by financing activities for the first fiscal quarter of 2009 increased approximately $641,000 when compared to the first fiscal quarter of 2008. This increase is a function of increased borrowing under our revolving credit facility. As of both May 2, 2008 and January 31, 2008 we were not in compliance with certain debt covenants with our lender and consequently, all of our debt with our lender is classified as current in our consolidated balance sheets at both May 2, 2008 and January 31, 2008. We currently have a written waiver through June 30, 2008 relating to our noncompliance and are currently in negotiations with our lender. We expect to renegotiate our debt agreements to ensure compliance throughout fiscal year 2009. If we do not renegotiate such agreements and are not in compliance with such agreements, our lender may accelerate the maturity of the notes. Based upon an analysis of our contracts in place and our current backlog, we believe we will be able to generate sufficient cash flows to fund our operating needs through the remainder of fiscal 2009. If certain of these events do not materialize, we believe other alternatives exist to meet our cash requirements. Although we have challenges ahead of us, we believe our current plans will allow us to improve our operational performance for the fiscal year 2009.

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Our ability to maintain sufficient liquidity in fiscal year 2009 and beyond is highly dependent upon achieving expected operating results. Failure to successfully achieve these results could have a material adverse effect on our liquidity and operations in the remainder of fiscal year 2009, and could require implementation of curative measures, including deferring planned capital expenditures, reducing discretionary spending, and/or, if necessary, selling assets.

Working Capital and Capital Expenditures

Our working capital at May 2, 2008 was $2,204,000 compared to $2,430,000 at January 31, 2008. The reduction in working capital during the first fiscal quarter of 2009 related primarily to an increase in borrowings under our revolving credit facility.

The accounts receivable days outstanding decreased to 65 days at May 2, 2008, compared to 66 days at January 31, 2008. Credit terms provided to customers are consistent with those normally offered in our industry.

Future capital requirements depend on numerous factors, including research and development, expansion of product lines and other factors. Furthermore, we may need to develop and introduce new or enhanced products, respond to competitive pressures, invest or acquire businesses or technologies or respond to unanticipated requirements or developments, which would require additional resources. Currently, negative cash flow from operations prohibits us from meeting these challenges through organic growth.

Our capital expenditures for first fiscal quarter of 2009 were $0 compared to $49,000 for first fiscal quarter of 2008. Historically, our capital budget has been intended to replace fixed asset equipment as needed and to take advantage of technological improvements that would improve productivity. We presently anticipate no additional significant capital expenditures until such time as our operating results and cash flows from operations improve.

Critical Accounting Policies

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

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

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

Accounts Receivable, Allowance for Doubtful Accounts and Credit Losses

Accounts receivable are reported at their outstanding principal balances reduced by an allowance for doubtful accounts. The Company continuously evaluates its customers and provides specific reserves for anticipated credit losses as soon as collection becomes compromised. The Company also maintains a reserve for accounts that management believes may become uncollectible based on historical experience. Measurement of such losses requires consideration of historical loss experience, including the need to adjust for current conditions, and judgments about the probable effects of relevant observable data, including present economic conditions such as delinquency rates and financial health of specific customers.

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Inventories

The Company values inventory at the lower of cost (using a method that approximates the first-in, first-out method (**FIFO**) or net realizable value. The reserve for obsolete and slow moving inventory is based upon reviews of inventory quantities on hand, usage and sales history.

During production, the Company uses standards to estimate product costs. These standards are reviewed and updated periodically by management and approximate costing under the FIFO method. Differences between standard and actual costs have not been material.

Long-Lived Assets

Management periodically evaluates long-lived assets for potential impairment and will record an impairment charge whenever events or changes in circumstances indicate the carrying amount of the assets may not be fully recoverable.

Property Held For Sale

Property held for sale is reported at the lower of its carrying amount or fair value less cost to sell. Depreciation on property held for sale is discontinued at the time the criteria established by Statement of Financial Accounting Standards (**SFAS**) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets (as amended),* are met. The Earlysville, Virginia property is presently held for sale. The property consists of a 53,000 square foot manufacturing facility on approximately 12 acres of land. In preparation for the sale of the Earlysville, Virginia facility, the Company engaged an environmental consulting firm to survey the property for any possible soil or groundwater contamination. This survey revealed impacts to both shallow soils and groundwater that may have resulted from the accidental loss of solvents by a former owner of the property. As a result of the initial and subsequent surveys, contamination treatment was determined to be necessary for an estimated total cost of $588,000, as determined by an environmental compliance specialist. The Company has capitalized these contamination treatment costs as an increase to property held for sale, net, since such costs will be incurred in preparation for the sale of the Earlysville, Virginia facility.

Goodwill and Intangible Assets

The carrying value of goodwill is reviewed at least annually for impairment and will be reviewed more frequently if current events and circumstances indicate a possible impairment. An impairment loss is charged to expense in the period identified. As current events and circumstances warrant, the Company examines the carrying value of its intangible assets with finite lives, such as capitalized software and development costs, purchased intangibles, and other long-lived assets, to determine whether there are any impairment losses. If indicators of impairment are present and future cash flows are not expected to be sufficient to recover the asset s carrying amount, an impairment loss is charged to expense in the period identified. Factors that may cause an impairment include negative industry or economic trends or significant underperformance relative to historical or projected future operating results.

Income Taxes

The Company and its includable subsidiaries file a consolidated U.S. federal income tax return in accordance with the provisions of the Internal Revenue Code of 1986, as amended.

The Company s accounting for income taxes represents management s best estimate of various events and transactions.

Deferred tax assets and liabilities resulting from temporary differences between the financial reporting and tax bases of assets and liabilities are measured at the balance sheet date using enacted tax rates expected to apply to taxable income in the years the temporary differences are expected to reverse.

The realization of deferred tax assets depends upon the existence of sufficient taxable income within the carryback or carryforward periods under the tax law in the applicable tax jurisdiction. Valuation allowances are established when management determines, based on available information, that it is more likely than not that deferred income tax assets will not be realized. Significant judgment is required in determining whether valuation allowances should be established as well as the amount of such allowances. When making such determination, consideration is given to, among other things, the following:

future taxable income exclusive of reversing temporary differences and carryforwards;

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- future reversals of existing taxable temporary differences;
- taxable income in prior carryback years; and
- Tax planning strategies.

The Company classifies tax related interest and tax related penalties as a component of income taxes.

Revenue Recognition

The Company generally recognizes revenue from sales of its products when the following have occurred: evidence of a sale arrangement exists; delivery or shipment has occurred or services have been rendered; the price to the buyer is fixed or determinable; and collectibility is reasonably assured.

The Company follows the percentage-of-completion method of accounting for one long-term engineering service contract. Under this method, contract revenue is computed as that percentage of estimated total revenue that costs incurred to date bear to total estimated costs, after giving effect to the most recent estimates of costs to complete. From time to time, the Company will record costs and estimated profits in excess of billings for certain of these contracts. Revisions in costs and revenue estimates are reflected in the period in which the revisions are determined. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined without regard to the percentage-of-completion.

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

As a general matter, the terms specified in customer purchase orders determine whether the Company or the customer bears the obligation for payment of freight charges. While customers pay for freight in most transactions, the Company does occasionally pay freight charges on behalf of customers and bill all or a portion to customers.

Research and Development

Research and development costs are expensed as incurred and are included in selling, general and administrative expenses.

Environmental Expenditures

The Company assesses its property held for sale, along with any property that is being taken out of its initially intended use, for the presence of hazardous or toxic substances that would result in an environmental liability. In addition, management assesses its current property in use for any environmental issues.

Liabilities for environmental remediation costs not related to retirements of tangible long-lived assets, and arising from claims, assessments, litigation, fines, and penalties and other sources, are recorded when it is probable that a liability has been incurred and the amount of the assessment and/or remediation can be reasonably estimated.

Legal costs incurred in connection with environmental remediation are expensed as incurred. Recoveries of environmental remediation costs from third parties, which are probable of realization, are separately recorded as assets, and are not offset against the related environmental liability, in accordance with Financial Accounting Standards Board (**FASB**) Interpretation (**FIN**) No. 39, *Offsetting of Amounts Related to Certain Contracts*.

Share-Based Compensation

Effective February 1, 2006, the Company adopted, using the modified prospective transition method, SFAS No. 123 (revised 2004), *Share-Based Payment* (**SFAS 123(R)**), which replaces SFAS 123 and supersedes APB 25 and recognized share-based employee compensation cost as a charge to net income. Under this transition method, compensation expense associated with stock options recognized in the first quarter of fiscal year 2007 and subsequent quarters, includes expense related to the remaining unvested portion of all stock option awards granted prior February 1, 2006 based on the grant date fair value estimated in accordance with the original provisions of SFAS 123. The adoption of

SFAS 123(R) did not have a

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significant impact on the Company s financial position or results of operations. SFAS 123(R) requires that the cost of all share-based transactions be measured at fair value and recognized over the period during which a grantee is required to provide goods or services in exchange for the award. Although the terms of the Company s share-based plans do not accelerate vesting upon retirement, or the attainment of retirement eligibility, the requisite service period subsequent to attaining such eligibility is considered nonsubstantive. Accordingly, the Company recognizes compensation expense related to share-based awards over the shorter of the requisite service period or the period to attainment of retirement eligibility. SFAS 123(R) also requires an estimation of future forfeitures of share-based awards to be incorporated into the determination of compensation expense when recognizing expense over the requisite service period.

Off-Balance Sheet Arrangements

The Company does not maintain off-balance sheet arrangements except as disclosed in our Annual Report on Form 10-K for the year ended January 31, 2008 nor does it participate in non-exchange traded contracts requiring fair value accounting treatment.

Contractual Obligations

There have been no material changes to our commitments and contingencies from that disclosed in our Annual Report on Form 10-K for the year ended January 31, 2008.

Recent Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board (**FASB**) issued Statement of Financial Accounting Standards (**SFAS**) No. 159, *The Fair Value Option for Financial Assets and Liabilities* (**SFAS 159**). SFAS 159 permits companies to make an election to carry certain eligible financial assets and liabilities at fair value, even if fair value measurement has not historically been required for such assets and liabilities under U.S. GAAP. Effective February 1, 2008, the Company did not elect the fair value option for any instruments.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (**SFAS 157**). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with U.S. GAAP, and expands disclosures about fair value measurements. The Company was required to adopt the provisions of SFAS 157 in the first quarter of the fiscal year beginning February 1, 2008. The adoption of SFAS 157 had no effect on the Company s consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations A Replacement of FASB Statement No. 141* (**SFAS 141(R)**). SFAS 141(R) retains the fundamental requirements in SFAS No. 141, *Business Combinations* (**SFAS 141**), that the acquisition method of accounting (which SFAS 141 called the *purchase method*) be used for all business combinations and that an acquirer be identified for each business combination. It also retains the guidance in SFAS 141 for identifying and recognizing intangible assets separately from goodwill. However, SFAS 141(R) will change the accounting treatment for certain specific items, including:

- All business combinations (whether full, partial, or step acquisitions) will result in all assets and liabilities of an acquired business being recorded at fair value, with limited exceptions;
- Acquisition costs will be generally expensed as incurred;
- The fair value of the purchase price, including the issuance of equity securities, will be determined on the acquisition date;
- Purchases or sales of equity interests that do not result in a change in control will be accounted for as equity transactions. Upon a loss of control, the interest sold, as well as any interest retained, will be measured at fair value, with any gain or loss recognized in earnings;
- Non-controlling interests (formerly known as minority interests) will be valued at fair value at the acquisition date;

Certain acquired contingent liabilities will be recorded at fair value at the acquisition date and subsequently measured at either the higher of such amount or the amount determined under existing guidance for non-acquired contingencies;

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Restructuring costs associated with a business combination will be generally expensed subsequent to the acquisition date; and

Changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date generally will affect income tax expense.

SFAS 141(R) also includes a substantial number of new disclosure requirements. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. SFAS 141(R) will have an effect on the Company s future acquisitions.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not issue or invest in financial instruments or their derivatives for trading or speculative purposes. Our market risk is limited to fluctuations in interest rates pertaining to our borrowings under our existing credit facilities which require the payment of interest at a variable rate equal to one-month LIBOR plus 300 basis points. We therefore are exposed to market risk from changes in interest rates on funded debt. Any increase in these rates could adversely affect our interest expense. The extent of market rate risk associated with fluctuations in interest rates is not quantifiable or predictable because of the volatility of future interest rates and business financing requirements. We use no derivative products to hedge or mitigate interest rate risk.

Based on the outstanding balance on our credit facilities as of May 2, 2008, a 1% increase in interest rates would cost us approximately $79,000 annually.

ITEM 4. CONTROLS AND PROCEDURES

We evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act, as of May 2, 2008. Our principal executive and financial officers supervised and participated in the evaluation. Based on the evaluation, and in light of the previously identified material weakness in internal control over financial reporting, as of January 31, 2008, described within the 2008 Annual Report on Form 10-K, our principal executive and financial officers each concluded that, as of May 2, 2008, our disclosure controls and procedures were not effective in providing reasonable assurance that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s form and rules.

Changes in Internal Control Over Financial Reporting

Since January 31,2008, including the period covered by this Quarterly Report, we have made certain changes to our internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) which are likely to have a material effect on such controls. For a discussion of these changes, please refer to Item 9A. CONTROLS AND PROCEDURES in our Annual Report on Form 10-K for the year ended January 31, 2008.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

The risk factors included in our Annual Report on Form 10-K for the year ended January 31, 2008 have not materially changed.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

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

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

Exhibit No.	Description of Exhibit
31.1	Section 302 Certification
31.2	Section 302 Certification
32.1	Section 906 Certification
32.2	Section 906 Certification

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SIGNATURES

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

Date: June 16, 2008

AEROSONIC CORPORATION

/s/ Douglas Hillman
Douglas Hillman

President and Chief Executive Officer

Date: June 16, 2008

AEROSONIC CORPORATION

/s/ Charles Pope
Charles Pope
Executive Vice President and Chief Financial Officer