AVIATION GENERAL INC
Form 10-Q
May 15, 2001

==

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

X QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2001

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

Commission File Number: 0-24795

AVIATION GENERAL, INCORPORATED
(Exact name of registrant as specified in its charter)

Delaware (State of Incorporation)	73-1547645 (IRS Employer Identification No.)
7200 NW 63rd Street Hangar 8, Wiley Post Airport Bethany, Oklahoma (Address of principal executive offices)	73008 (Zip Code)

(405) 440-2255
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports 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 requirement for the past 90 days.

Yes__X__ No_____

There were 6,279,330 Shares of Common Stock Outstanding as of May 10, 2001.

==

PART I. FINANCIAL INFORMATION
ITEM I. FINANCIAL STATEMENTS

AVIATION GENERAL, INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	(Unaudited) March 31, 2001
ASSETS	
Current Assets	
Cash and cash equivalents	109,407
Accounts receivable	15,703
Current portion of note receivable	22,027
Inventories	9,019,280
Prepaid expenses and other assets	176,739
Total current assets	9,343,156
Property and equipment	
Office equipment and furniture	367,311
Vehicles and aircraft	95,115
Manufacturing equipment	385,179
Tooling	676,027
Leasehold improvements	311,764
	1,835,396
Less accumulated depreciation	(1,101,462)
	733,934
Other assets	
Notes receivable, less current maturities	93,121
Available-for-sale equity securities - related party	402,000
Note receivable from related party	1,529,889
	2,025,010
	$12,102,100

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

AVIATION GENERAL, INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	(Unaudited) March 31, 2001
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities	
Accounts payable	$1,501,973
Accrued expenses	472,662
Refundable deposits	89,166
Notes payable	3,968,000
Total current liabilities	6,031,801
DEFERRED TAX LIABILITY	-
Stockholders' Equity	
Preferred stock, $.01 par value, 5,000,000 shares Authorized; no shares outstanding	-
Common stock, $.50 par value, 20,000,000 shares Authorized; 7,051,519 shares issued at March 31, 2001 and December 31, 2000	3,525,759
Additional paid-in capital	36,889,799
Less: Treasury stock at cost, 772,189 shares at March 31, 2001 and December 31, 2000	(1,294,193)
Accumulated other comprehensive income (loss)	(28,741)
Accumulated deficit	(33,022,325)
Total stockholders' equity	6,070,299
	$12,102,100

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

AVIATION GENERAL, INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended March 31, 2001	2000
Net sales - aircraft	$2,134,212	$3
Net sales - service	505,548	
Total net sales	2,639,760	3
Cost of sales - aircraft	1,813,500	2
Cost of sales - service	434,586	
Total cost of sales	2,248,086	3
Gross margin	391,674	
Other operating expenses		
Product development and engineering costs	95,307	
Selling, general and administrative expenses	818,359	
Total other operating expenses	913,666	
Operating income (loss)	(521,992)	
Other income (expenses)		
Other income	44,049	
Interest expense	(120,644)	
Other expense	-	
Total other income (expense)	(76,595)	
Net income (loss)	($598,587)	
Net income per share		
Weighted average common shares outstanding, basic	6,279,330	
Net income (loss) per share, basic	($0.10)	
Weighted average common shares Outstanding, diluted	6,279,330	
Net income (loss) per share, diluted	($0.10)	

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

AVIATION GENERAL, INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months Ended M
	2001
CASH FLOWS FROM OPERATING ACTIVITIES	
Net Income (Loss)	($598,587)
Adjustments to reconcile net income (loss) to net cash used by operating activities	
Depreciation and amortization	16,425
Non-cash interest earnings	(36,343)
Receipts on notes receivable - related party	-
Changes in assets and liabilities	
(Increase) decrease in	
Accounts receivable	535,722
Notes receivable	6,401
Inventories	(1,027,109)
Prepaid expense and other assets	13,094
Increase (decrease) in	
Accounts payable	275,559
Accrued expenses	(88,736)
Refundable deposits	(26,648)
Net cash provided (used) by operating activities	(930,222)
CASH FLOWS FROM INVESTING ACTIVITIES	
Purchase of securities of related party	-
Capital expenditures	(28,387)
Payment on related party note receivable	-
Net cash (used) provided by investing activities	(28,387)
CASH FLOWS FROM FINANCING ACTIVITIES	
Proceeds from borrowings	1,988,013
Payments on borrowings	(1,055,013)
Purchase of treasury stock	-
Net cash provided by financing activities	933,000
Net increase (decrease) in cash	(25,609)
Cash and cash equivalents at beginning of period	135,016
Cash and cash equivalents at end of period	$109,407

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION	
Cash paid during the period for:	
Interest	$126,060

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

AVIATION GENERAL, INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. The condensed financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations; however, the Company believes that the disclosures are adequate to make the information presented not misleading. In the opinion of the Company, all adjustments necessary to present fairly the financial position of Aviation General, Incorporated as of March 31, 2001 and December 31, 2000, and the results of operations and cash flows for the three month period ended March 31, 2001 and 2000 have been included and are of a normal, recurring nature. The results of operations for such interim periods are not necessarily indicative of the results for the full year. It is suggested that these condensed financial statements be read in conjunction with the Company's 2000 Annual Report on Form 10-K.

2. Basic income (loss) per share of common stock has been computed by using the weighted average number of shares of common stock outstanding during the period. Diluted income (loss) per share has been computed based on the assumption that all dilutive options are exercised.

	Three months ending	
	March 31, 2001	March 31, 20
Numerator		
Net income (loss)	($598,587)	$38,18
Denominator		
Weighted average shares outstanding, basic	6,279,330	6,449,72
Effect of dilutive securities		
Stock options	0	264,00
Denominator for income (loss) per share assuming dilution	6,279,330	6,713,72

Income (loss) per share, basic	($ 0.10)	$ 0.0
Income (loss) per share, assuming dilution	($ 0.10)	$ 0.0

4. Total comprehensive income (loss) for the periods presented is as follows:

	For the three months ending March 31, 2001	2000
Net income	($598,587)	$38,183
Other comprehensive income (loss)	(142,432)	591,143
Comprehensive income (loss)	($741,019)	$629,326

5. Inventories consist primarily of finished goods and parts for manufacturing and servicing aircraft. Inventory costs include all direct manufacturing costs and applied overhead. These inventories, other than used aircraft, are stated at the lower of cost or market, and cost is determined by the average-cost method. Used aircraft are valued on a specific-identification basis at the lower of cost or current estimated realizable wholesale price. Inventory components at the balance sheet dates were as follows:

	March 31, 2001	December 31, 2000
Raw materials	$2,435,414	$2,522,930
Work in process	1,986,981	1,710,363
New and pre-owned aircraft	4,539,990	3,663,866
Other	56,895	95,012
Total inventories	$9,019,280	$7,992,171

6. The effective tax rate differs from the statutory rate primarily to utilization of net operating loss carryforwards and the change in the valuation allowance for deferred income tax assets

7. The Company is subject to regulation by the FAA. The Company is subject to inspections by the FAA and may be subjected to fines and other penalties (including orders to cease production) for noncompliance with FAA regulations. The Company has a Production Certificate from the FAA, which delegates to the Company the inspection of each aircraft. The sale of the Company's product internationally is subject to regulation by comparable agencies in foreign countries.

The Company faces the inherent business risk of exposure to product liability claims. In 1988, the Company agreed to indemnify a former manufacturer of the Commander single engine aircraft against claims asserted against the manufacturer with respect to aircraft built from 1972 to 1979. In 1994, Congress enacted the General Aviation Revitalization Act, which established an eighteen-year statute of repose for general aviation manufacturers. This legislation prohibits product liability suits against manufacturers when the aircraft involved in an accident is more than eighteen years old. This action effectively eliminated all potential liability for the Company with respect to aircraft produced in the 1970s as of December 31, 1997. The Company's product liability insurance policy with coverage of $10 million per occurrence and $10 million annually in the aggregate with a deductible of $200,000 per occurrence and annually in the aggregate expired March 1, 1995. Subsequent to March 1, 1995, the Company is not insured for product liability claims. Management believes that the interest of shareholders is better served by vigorously defending claims through the services of highly qualified specialists and attorneys rather than retaining product liability insurance to settle exorbitant claims.

The Company is routinely involved in various legal matters arising in the normal course of business, including product liability claims. Management intends to vigorously defend against these claims and currently believes that legal matters will not result in any material adverse effect on the Company's financial position or results of operations. Accordingly, no provision for any liabilities that may result have been recorded in the financial statements.

8. The Company's business strategy is to capture a significant share of the existing domestic and international market for the single engine, high performance aircraft by offering a premium updated version of an established aircraft design. Commander aircraft have an airframe design decades newer than the competition and are certified to more stringent standards. In addition, Commander aircraft have a significantly better safety record and higher resale value than all other aircraft in their class. The Company believes the domestic and international market for its aircraft includes individuals and corporations that will purchase the Company's aircraft for business and personal travel, and governments, commercial and military organizations that will use the aircraft for training and other purposes.

The Company believes the market for its products will improve as a result of attrition of the existing fleet of aging single engine high performance aircraft, development of new international markets for general aviation aircraft, increased use of single engine aircraft as a corporate tool for small and medium-sized businesses, and demand for advanced single engine trainers.

Recognizing that the size of the pre-owned aircraft market is significantly larger than new aircraft sales, the Company has structured a separate aviation services division within the Company to purchase, refurbish and sell pre-owned piston aircraft at reasonable profit margins. The Aviation Services Division also acts as broker for pre-owned piston aircraft and serves as advisor to potential aircraft buyers and sellers.

The Company markets its aircraft through a factory direct sales and marketing organization comprised of regional sales personnel who are managed and supported from the Company's headquarters in Oklahoma. The marketing organization is augmented by a worldwide network of Commander Authorized Service Centers (ASCs). The Company's marketing program utilizes a highly focused domestic and international advertising and public relations program that includes product advertising in leading business and aviation publications, ongoing direct mail programs to owners and pilots, and internet marketing communications.

The Company has one of the most comprehensive worldwide service and support networks in its class. The Company grants domestic Commander ASCs the non-exclusive right to refer prospects for new Commander aircraft. Commander ASCs receive a referral fee for identifying purchasers, and provide a full complement of service and support services, including financing, insurance, service and support, hangar/storage, flight instruction, and professional pilot service. The Company selects ASCs from among experienced independent aviation sales and service organizations that it believes to have excellent facilities, service capabilities, reputation and financial strength. Through its ASCs, Commander Aircraft Company offers a turn-key aircraft ownership program designed to stimulate ownership of Commander aircraft by companies that have not previously owned or operated aircraft. This flexible program can be tailored to meet each customer's specific requirements.

PART I. FINANCIAL INFORMATION
ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

RESULTS FROM OPERATIONS

Revenues from the sale of aircraft for the first quarter of 2001 totaled $2,134,212 compared to $3,475,750 for the comparable period of 2000. For the first quarter of 2001, eight new and pre-owned aircraft were sold, compared with fifteen new and pre-owned aircraft sold in the same period for 2000. The revenues for the first quarter of 2001 were adversely impacted by the uncertainty of the economy, causing customer cancellation or postponement of new and pre-owned aircraft purchases. Thus, the Company has made and will continue to make appropriate adjustments in its cost and overhead structure. The Company believes business will begin to pick up as economic and stock market conditions stabilize, and as the effect of lower interest rates, which significantly lowers aircraft purchase finance costs, takes hold. The Company expects to return to profitability in the second half of the year.

Service revenues totaled $505,548 for the quarter ended March 31, 2001 compared to $466,825 for the comparable quarter in 2000. The increase was partially due to increased aircraft repair and refurbishment activity.

Cost of aircraft sales for the three months ended March 31, 2001 decreased to $1,813,500 compared to $2,779,963 for the three months ended March 31, 2000. The decrease in cost was due to lower new and pre-owned aircraft sales during the period.

Cost of sales for service and parts for the quarter ended March 31, 2001 increased to $434,586 compared to $317,996 for the quarter ended March 31, 2000. The increase was due to the increase in service activity and was partially offset by a decrease in after-market parts sales activity.

Aircraft sales margins were lower for the three months ended March 31, 2001 compared to the prior period due to the decrease in sales volume of new and pre-owned aircraft. Service margins were lower for the three months ended March 31, 2001 compared to the prior period because of a decrease in the sale of after-market parts.

Product development and engineering costs decreased to $95,307 for the first quarter of 2001, from $96,307 for the comparable period in 2000.

Sales, general and administrative expense increased for the three months ended March 31, 2001, to $818,359 from $733,865 for the comparable period ended March 31, 2000, as a result of increased legal expense.

Interest expense increased to $120,644 for the first quarter of 2001 from $30,532 for the comparable period in 2000 due to higher borrowings to finance aircraft manufactured or purchased for resale.

LIQUIDITY AND CAPITAL RESOURCES

Cash balances decreased slightly to $109,407 at March 31, 2001 from $135,016 at December 31, 2000. Accounts receivable decreased by $535,722 at March 31, 2001 due to a payment received in the first quarter for an aircraft in accounts receivable at December 31, 2000.

Notes receivable decreased to $115,148 at March 31, 2001 from $121,549 at December 31, 2000 due to regular quarterly payments from the debtor. Notes receivable from related parties remained unchanged from December 31, 2000 to March 31, 2001. Accrued interest due on the note receivable from the related party at March 31, 2001 was $36,343. The note is secured by Aviation General, Incorporated stock pledged, as well as a personal guarantee from the principal shareholder of the debtor. The note is classified as non-current due to the probability that payment in full will not occur within the next year.

The Company's investment in equity securities is classified as available for sale with unrealized gains or losses excluded from income and reported as other comprehensive income or loss. Declines in the fair value of securities that are other than temporary result in write-downs are included in earnings. This investment is in the common stock of a related party.

Inventories increased to $9,019,280 at March 31, 2001 from $7,992,171 at December 31, 2000. Raw materials, parts and work in process increased approximately $150,985 as the Company increased production of new aircraft to meet anticipated market demand. New and pre-owned aircraft inventory increased by $876,124.

During the first three months of 2001, expenditures for fixed assets totaled $28,386, which included replacement of machinery and fabrication tooling.

Accounts payable increased to $1,501,973 at March 31, 2001 from $1,226,414 at December 31, 2000, as the anticipated increase in production of new aircraft in 2001 resulted in higher material and parts inventory purchased on open account. Accrued expenses decreased to $472,662 at March 31, 2001 from $561,398 at December 31, 2000. The decrease in accrued expenses is attributable to disbursement of property taxes and payroll that were included in normal expense accruals at December 31, 2000.

Refundable deposits decreased to $89,166 at March 31, 2001 from $115,814 at December 31, 2000. Borrowings from bank lines increased to $3,968,000 at March 31, 2001 from $3,035,000 at December 31, 2000 to offset the decrease in cash flow from lower sales volume.

The Company formed Strategic Jet Services, Inc. (SJS), a wholly owned subsidiary, to provide brokerage, sale, consulting and refurbishment work for jet aircraft. This line of business generated first activity in 1999, contributed revenue in 2000, and is expected to contribute additional revenue in 2001.

The Company continues to certify new state-of-the-art avionics systems that offer the customer the latest technology in navigational and communication equipment. The Company introduced a new de-icing option and received certification from the Federal Aviation Administration, allowing equipped aircraft to operate in known icing conditions similar to larger, more expensive aircraft. Sales of this equipment not only provide additional revenues and earnings, but also increase the value of the aircraft relative to its competition.

During 2000, the Company introduced the 115 series of high performance, single engine aircraft. The Commander 115 represents the culmination of a multitude of improvements to the Commander line, and features numerous airframe, engine and systems refinements, as well as significantly increased range capability and an upgraded standard avionics package which includes dual Garmin 430 global navigation, communication and moving map displays. The Commander 115 series is the latest of a thoroughbred line of aircraft that offer the ultimate combination of performance, comfort, safety, and utility, and has become recognized as the Mercedes of the single engine fleet.

In addition to the above actions by the Company to increase revenue, management has made efforts to reduce costs and cash requirements by optimizing its production schedule using just-in-time scheduling. Management has reduced the costs incurred to advertise new aircraft by focusing marketing efforts at a specific customer profile.

The Company continues to advertise in industry and trade publications at a significantly reduced level, while directly contacting potential customers whose demographic characteristics closely match the typical customer, especially in the areas of income, pilot experience, and types of businesses with demonstrated regional travel requirements. Further reducing selling expenses, the Company has organized its service center, paint, interior and avionics shops into a completion center to focus on the growing after-market refurbishment business.

The Company has expanded its operations to include SJS, enhanced the Commander brand with the introduction of the Commander 115, and more effectively targeted sales and marketing expenditures. With continued activity in the parts, service and pre-owned aircraft sales, the Company has lowered its break even sales to only 15 new aircraft per year. With the large investment complete, management believes it has made significant progress towards the building of a world class aviation company which will achieve sustained annual profitability. Due to numerous factors beyond the control of the Company, there can be no assurances that these results will be achieved.

Forward Looking Statements

This Form 10-Q includes certain statements that may be deemed to be "forward-looking statements" within the meaning of Section 27A of the Securities Act. All statements, other than statements of historical fact, included in this Form 10-Q that addresses activities, events or developments that the Company expects, projects, believes, or anticipates will or may occur in the future, including matters having to do with expected and future aircraft sales and services revenues, the Company's ability to fund its operations and repay debt, business strategies, expansion and growth of operations and other such matters, are forward-looking statements. These statements are based on certain assumptions and analyses made by our management in light of its experience and its perception of historical trends, current conditions, expected future developments, and other factors it believes are appropriate in the circumstances. These statements are subject to a number of assumptions, risks and uncertainties, including general economic and business conditions, the business opportunities (or lack thereof) that may be presented to and pursued by the Company, the Company's performance on its current contracts and its success in obtaining new contracts, the Company's ability to attract and retain qualified employees, and other factors, many of which are beyond the Company's control. You are cautioned that these forward-looking statements are not guarantees of future performance and that actual results or developments may differ materially from those projected in such statements.

PART I. FINANCIAL INFORMATION
ITEM 3. QUANITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The registrant has no material market risk associated with interest rates, foreign currency exchange rates or commodity prices.

PART II. OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Reports on Form 8-K - None.

SIGNATURE

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.

AVIATION GENERAL INCORPORATED
(Registrant)

By: /s/ Wirt D. Walker
Wirt D. Walker
Chairman of the Board of Directors
(Chief Executive Officer and
Authorized Signatory)

Date: May 14, 2001