AER ENERGY RESOURCES INC /GA
Form 10-Q
May 15, 2001

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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 March 31, 2001

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 0-21926

AER ENERGY RESOURCES, INC.
(Exact name of registrant as specified in its charter)

Georgia	34-1621925
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

4600 Highlands Parkway, Suite G, Smyrna, Georgia	30082
(Address of principal executive offices)	(Zip Code)

(770) 433-2127
(Registrant's telephone number, including area code)

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 [ ]

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of Common Stock, as of the latest practicable date.

There were 24,850,263 shares of Common Stock outstanding as of May 7, 2001.

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AER ENERGY RESOURCES, INC.
FORM 10-Q
FOR THE QUARTER ENDED MARCH 31, 2001

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

AER ENERGY RESOURCES, INC.
(A DEVELOPMENT STAGE COMPANY)
CONDENSED BALANCE SHEETS

	MARCH 31 2001 (Unaudite
ASSETS	
Current assets:	
Cash and cash equivalents	$ 600,4
Trade accounts receivable	3,5
Inventories	88,0
Prepaid expenses and other current assets	78,7
Total current assets	770,8
Equipment and improvements	3,426,3
Less accumulated depreciation	(3,143,7
	282,6
Other assets	10,5
TOTAL ASSETS	$ 1,064,0
LIABILITIES AND STOCKHOLDERS' DEFICIT	
Current liabilities:	
Accounts payable	$ 109,5
Deferred revenue	179,6
Other accrued expenses	121,3
Total current liabilities	410,5
Redeemable convertible preferred stock, no par value, in series:	
Series A: authorized - 425,000 shares; 404,500 shares issued and outstanding at March 31, 2001 and December 31, 2000; liquidation preference and redemption price of $4,184,552 as of March 31, 2000 (including $139,552 undeclared dividends)	3,487,1
Series B: authorized - 250,000 shares; 102,250 shares issued and outstanding at March 31, 2001; liquidation preference and redemption price of $1,028,663 as of March 31, 2001 (including $6,163 undeclared dividends)	728,0
Total liabilities and redeemable convertible preferred stock	4,625,6
Stockholders' deficit:	
Preferred stock, no par value:	
Authorized - 10,000,000 shares; no shares issued and outstanding	
Common stock, no par value:	
Authorized - 100,000,000 shares; 24,850,263 shares issued and outstanding at March 31, 2001 and December 31, 2000	67,364,9
Unearned stock compensation	(23,1
Deficit accumulated during the development stage	(70,903,4

Total stockholders' deficit	(3,561,5
TOTAL LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK, AND STOCKHOLDERS' DEFICIT	$ 1,064,0

See notes to condensed financial statements.

AER ENERGY RESOURCES, INC.
(A DEVELOPMENT STAGE COMPANY)
CONDENSED STATEMENTS OF OPERATIONS
(UNAUDITED)

	THREE MONTHS ENDED MARCH 31, 2001	2000	P JU IN
License fees and research and development revenues	$ 107,813	$ 107,814	$
Product sales	--	--	
Cost of product sales	--	--	
Gross margin on product sales	--	--	
	107,813	107,814	
Costs and expenses:			
Research and development			
- related party	--	--	
- other	777,547	921,768	
Marketing, general and administrative			
- related party	--	--	
- other	413,986	458,676	
Total costs and expenses	1,191,533	1,380,444	
Operating loss	(1,083,720)	(1,272,630)	
Interest income	3,259	13,437	
Interest expense - related parties	--	--	
Net loss	(1,080,461)	(1,259,193)	
Accretion of redeemable preferred stock	(37,421)	--	
Redeemable preferred stock dividends	(74,422)	--	
Net loss attributable to common stock	$ (1,192,304)	$ (1,259,193)	$
Net loss per share (basic and diluted)	$ (0.05)	$ (0.05)	$

Weighted average shares outstanding (basic and diluted)	24,850,263	24,850,263	

See notes to condensed financial statements.

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AER ENERGY RESOURCES, INC.
(A DEVELOPMENT STAGE COMPANY)
CONDENSED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	THREE MONTHS ENDED MARCH 31, 2001	2000
OPERATING ACTIVITIES:		
Net loss	$(1,080,461)	$(1,259,193)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	47,676	87,557
Amortization of unearned stock compensation	8,737	8,736
Amortization of discount on promissory notes	--	--
Grant of compensatory stock options	--	--
Forgiveness of promissory notes	--	--
Loss on disposal of equipment	--	--
Accretion of discount on short-term investments and marketable securities	--	--
Net changes in operating assets and liabilities	(130,848)	(128,926)
Net cash used in operating activities	(1,154,896)	(1,291,826)
INVESTING ACTIVITIES:		
Purchases of equipment and improvements	(6,904)	(5,233)
Purchases of short-term investments and marketable securities	--	--
Purchase of license agreement	--	--
Proceeds from sales/maturities of short-term investments and marketable securities	--	--
Changes in other assets	--	--
Net cash used in investing activities	(6,904)	(5,233)
FINANCING ACTIVITIES:		
Proceeds from revolving credit note to related parties	--	--
Issuance of convertible debentures, net of issuance costs	--	--
Proceeds from convertible notes payable to related parties	--	--
Payments on notes payable to related parties	--	--
Payments received on promissory notes	--	--
Issuance of common stock upon exercise of stock options	--	--
Issuance of common stock, net of issuance costs	--	--
Issuance of redeemable convertible preferred stock, net of		

issuance costs	980,941	--
Net cash provided by financing activities	980,941	--
(Decrease) increase in cash and cash equivalents	(180,859)	(1,297,059)
Cash and cash equivalents at beginning of period	781,314	1,761,268
Cash and cash equivalents at end of period	$ 600,455	$ 464,209

See notes to condensed financial statements.

AER ENERGY RESOURCES, INC.
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION

The accompanying unaudited condensed financial statements of AER Energy Resources, Inc. (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. These financial statements should be read in conjunction with the Company's audited financial statements included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission for the year ended December 31, 2000. Operating results for the three month period ended March 31, 2001 are not necessarily indicative of the results that may be expected for the year ended December 31, 2001 or any interim period.

2. SIGNIFICANT ACCOUNTING POLICIES

Cash and Cash Equivalents

Cash and cash equivalents consist of cash, bank deposits and highly liquid investments with maturities of three months or less when purchased and are stated at cost, which approximates market.

Inventories

The Company's inventories are valued at the lower of cost or market, using the first in, first out (FIFO) method. The inventories balances at March 31, 2001 and December 31, 2000 of $88,084 and $76,752, respectively, consist entirely of raw materials.

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.

In accordance with FASB Statement No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," the Company records impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those

assets are less than the carrying amounts of those assets. Based on the Company's estimate of future undiscounted cash flows, the Company expects to recover the carrying amounts of its remaining fixed assets. The Company's estimates of future undiscounted cash flows have taken into consideration its current research and development operations and contemplate the Company entering into license agreements and research and development agreements, similar, or somewhat similar, to the 1998 agreement with Duracell Inc., throughout the remaining useful lives of the Company's fixed assets. If the Company is unable to enter into such agreements, a write down of long-lived assets to fair value may be required. No write-offs of obsolete equipment were recorded in either of the three-month periods ended March 31, 2001 or 2000.

3. PREFERRED STOCK AND WARRANT TRANSACTION

On February 27, 2001, the Company issued 102,250 shares of Series B Convertible Preferred Stock ("Series B Preferred") and a warrant to purchase up to 776,699 shares of common stock for a total purchase price, net of transaction fees, of $0.98 million to one of the major shareholders of the Company, Elmwood Partners II (affiliated with Jon Lindseth). The Series B Preferred may be converted, at the option of the holder, to common stock of the Company at any time at a conversion price of $0.515 per share, subject to various possible adjustments. The Company may redeem the Series B Preferred at a price equal to $10.00 per share plus all accrued and unpaid dividends; and it must be redeemed in February 2006, unless previously converted. Dividends accrue at the rate of 6.75% per annum, are cumulative and compound annually.

The warrant is exercisable for five years and entitles the holder to purchase one share of common stock at an exercise price of $0.5376 per share, subject to various possible adjustments. The fair value for this warrant of $0.26 million, or $0.34 per share, was estimated at the date of grant using a Black-Scholes valuation model. The warrant value has been allocated to common stock and will be accreted to the Series B Preferred on a straight-line basis through the mandatory redemption date so that at such redemption date, the carrying amount of the Series B Preferred will equal the mandatory redemption value.

4. IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

The Company has adopted FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" effective January 1, 2001. There has been no impact on the Company's results of operations and financial position.

5. SUBSEQUENT EVENT

In April 2001, the Company signed a License and Development Agreement with Rayovac Corporation. Under this agreement the Company is licensing its zinc-air battery technology to Rayovac and performing design and development work for Rayovac. Rayovac will own the technology developed for it and the Company will have rights to utilize that technology. Rayovac purchased 656,858 shares of Company common stock for $250,000, and was issued warrants to purchase an additional 218,953 shares at $0.4567 per share, subject to various possible adjustments. Additionally, Rayovac paid $250,000 for a $250,000 promissory note which converts to common stock. Principal on the note is payable in cash only upon the occurrence of specified events of default.

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

GENERAL

The Company was incorporated in 1989 and has been engaged in the development and commercialization of high energy density zinc-air batteries. Until 1998, the Company's operations were focused primarily on developing and improving its technology, setting up the manufacturing process, testing and selling rechargeable zinc-air batteries, recruiting personnel, and similar activities. In 1998, the Company changed its strategy to research and product development of zinc-air technology with its focus in primary (disposable) batteries, rather than rechargeable batteries, and plans to commercialize the technology through alliances with battery and original equipment manufacturers ("OEMs"). This change allows the Company to capitalize on the capability of its patented Diffusion Air Manager technology and opportunities in hand-held electronic products like camcorders, cellular telephones, cordless telephones, digital cameras, and hand-held computers. The Diffusion Air Manager can extend zinc-air battery storage life by isolating the cells in zinc-air batteries from exposure to air during periods when the battery is in storage or not in use.

In September 1998, the Company announced its Technology Licenses and Services ("TLAS") Agreement with Duracell Inc., a subsidiary of The Gillette Company, making Duracell the first licensee of the Company's primary (non-rechargeable) zinc-air technology. Under the terms of the TLAS Agreement, Duracell agreed to license the rights to the Company's then existing patents. In addition, Duracell agreed to fund certain joint product development projects with the Company during 1999. Duracell owns technology developed under the projects it funds, and the Company has rights to utilize the technology. Duracell also has options to obtain certain other license rights. The current revenue of $0.11 million per quarter being recognized under this agreement will cease in the third quarter of 2001. In April 2001, the Company signed a License and Development Agreement with Rayovac Corporation.

Throughout 2001, the Company will continue to seek additional license agreements for its patented zinc-air technology with other companies, and focus on the development of prototype primary zinc-air batteries that utilize Diffusion Air Manager technology.

RESULTS OF OPERATIONS

Three Months Ended March 31, 2001 and 2000

The Company generated $0.11 million of license fees and research and development revenues under the TLAS Agreement with Duracell during both the first three months ended March 31, 2001 and 2000.

Research and development expenses decreased 16% to $0.78 million for the three months ended March 31, 2001 from $0.92 million for the same period in

2000. This decrease resulted primarily from reduced travel, legal, patent, depreciation, and materials expenses.

Marketing, general and administrative expenses decreased 10% to $0.41 million for the three months ended March 31, 2001 from $0.46 million for the same period in 2000. This decrease resulted primarily from increased sample sales and decreased travel, marketing, and investor relations, offset by increases in legal and insurance costs.

LIQUIDITY, CAPITAL RESOURCES AND FINANCIAL CONDITION

As of March 31, 2001, the Company had cash and cash equivalents of $0.60 million. The Company anticipates using these funds as needed to fund capital equipment purchases, research and product development efforts, marketing and licensing activities, production of prototype zinc-air battery products, development of alliances with battery manufacturers and OEMs, working capital and general corporate purposes as determined by management.

In February 2001, the Company received $0.98 million in cash, net of issuance costs, pursuant to the issuance of 102,250 shares of redeemable convertible preferred stock to AER's major shareholder, Elmwood Partners II (affiliated with Jon Lindseth). The preferred stock may be converted to common stock of the Company at a conversion price of $0.515 per share, subject to various possible adjustments, at any time at the option of the holder. The Company may redeem the preferred stock at a price equal to $10.00 per share plus all accrued and unpaid dividends at any time and it must be redeemed in February 2006, unless previously converted. Dividends accrue at the rate of 6.75% per annum, are cumulative and compound annually. A warrant to purchase a total of 776,699 shares of AER Energy common stock at $0.5376 per share, subject to various possible adjustments, was also issued to the investor. The warrant expires in February 2006.

Net cash and cash equivalents used in operating, investing, and financing activities decreased 86% to $0.2 million for the three months ended March 31, 2001 from $1.3 million for the same period in 2000 due primarily to the issuance of redeemable convertible preferred stock.

The Company currently anticipates that its existing cash and cash equivalents balance will fund operations and continue technology development at the current level of activity into the second quarter of 2001. The Company will need to raise additional funds through additional license agreements, research and development contracts, debt or equity. There can be no assurance that additional license agreements or research and development contracts or equity or debt financing will be available when needed or on terms acceptable to the Company.

The market price of the Company's common stock has fluctuated significantly since it began to be publicly traded in July 1993 and may continue to be highly volatile. Factors such as the ability of the Company to achieve development goals, ability of the Company to commercialize its battery technology, ability of the Company to license its technology, development of competing battery technologies, ability of the Company to protect its proprietary rights to its technology, improvements in conventional battery technologies, demand for and acceptance of the Company's products in the marketplace, ability to obtain commitments from battery companies and OEMs, impact of any future governmental regulations, impact of pricing or material costs, ability of the Company to raise additional funds, general market conditions and other factors affecting the Company's business that are beyond the Company's control may cause significant fluctuations in the market price of the Company's common stock. The market prices of the stock of many high technology companies have fluctuated substantially, often unrelated to the operating or research and development performance of the specific companies. Such market fluctuations could adversely affect the market price for the Company's common stock.

FORWARD LOOKING STATEMENTS

This report contains statements which, to the extent that they are not recitations of historical fact, may constitute "forward looking statements" within the meaning of applicable federal securities laws and are based on the Company's current expectations and assumptions. These expectations and assumptions are subject to a number of risks and uncertainties which could cause actual results to differ materially from those anticipated, which include but are not limited to the following: ability of the Company to achieve development goals, ability of the Company to commercialize its battery technology, ability of the Company to license its technology, development of competing battery technologies, ability of the Company to protect its proprietary rights to its technology, improvements in conventional battery technologies, demand for and acceptance of the Company's products in the marketplace, ability to obtain commitments from battery manufacturers and OEMs, impact of any future governmental regulations, impact of pricing or material costs, ability of the Company to raise additional funds and other factors affecting the Company's business that are beyond the Company's control. All forward looking statements contained in this report are intended to be subject to the safe harbor protection provided by applicable federal securities laws.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company has invested a portion of its cash and cash equivalents in highly liquid financial instruments. The Company has historically held, and plans in the future to hold, all such instruments until maturity. If the instruments were, for some reason not anticipated, redeemed earlier than their maturity, there might be a gain or loss on the transaction. The Company has no transactions which qualify for treatment under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities".

AER Energy is a trademark of AER Energy Resources, Inc.

PART II - OTHER INFORMATION

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

On February 27, 2001 the Company issued 102,250 shares of Series B Convertible Preferred Stock ("Series B Preferred") and a warrant to purchase up to 776,699 shares of common stock for a total purchase price, net of transaction fees, of $0.98 million to one of the major shareholders of the Company, Elmwood Partners II (affiliated with Jon Lindseth). The Series B Preferred may be converted, at the option of the holder, to common stock of the Company at any time at a conversion price of $0.515 per share, subject to various possible adjustments. The Company may redeem the Series B Preferred at a price equal to $10.00 per share plus all accrued and unpaid dividends; and it must be redeemed in February 2006, unless previously converted. Dividends accrue at the rate of 6.75% per annum, are cumulative and compound annually. The warrant is exercisable for five years and entitles the holder to purchase one share of common stock at an exercise price of $0.5376 per share, subject to various possible adjustments.

The issuance of the Series B Preferred and warrant was exempt from registration under the Securities Act of 1933, as amended, pursuant to Section 4(2), including Rule 506 of Regulation D promulgated thereunder. The purchaser of the Series B Preferred and warrant was an accredited investor under Regulation D.

The Series B Preferred ranks ahead of the Company's common stock and on a parity with the Company's Series A Preferred Stock as to payment of dividends and amounts upon liquidation, dissolution or winding-up, and therefore could adversely affect the holders of common stock with respect to such payments.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(A) EXHIBITS:

EXHIBIT NUMBER	DESCRIPTION OF EXHIBITS
3.1	Articles of Incorporation of the Company, as amended(1)
10.1	Securities Purchase Agreement dated as of February 27, 2001 by and between Elmwood Partners II and AER Energy Resources, Inc.
10.2	Warrant to Purchase Common Stock of AER Energy Resources, Inc. dated February 27, 2001 between Elmwood Partners II and AER Energy Resources, Inc.
10.3	License and Development Agreement dated as of April 6, 2001 between Rayovac Corporation and AER Energy Resources, Inc.
10.4	Warrant to Purchase Common Stock of AER Energy Resources, Inc. dated as of April 27, 2001 between Rayovac Corporation and AER Energy Resources, Inc.
10.5	Convertible Subordinated Promissory Note dated as of April 27, 2001 between Rayovac Corporation and AER Energy Resources, Inc.

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(1) Filed on March 30, 2001 as an Exhibit to the Registrant's Annual Report on Form 10-K (File No. 0-21926) for the year ended December 31, 2000 and

incorporated herein by reference.

(B) REPORTS ON FORM 8-K:

The registrant did not file any reports on Form 8-K during the three months ended March 31, 2001.

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.

AER ENERGY RESOURCES, INC.

Date: May 7, 2001

By: /s/ David W. Dorheim

David W. Dorheim, President and Chief Executive Officer

Date: May 7, 2001

By: /s/ J.T. Moore

J.T. Moore, Vice President, Chief Financial Officer, Secretary and Treasurer (Principal Financial Officer and Principal Accounting Officer)