

Edgar Filing: AER ENERGY RESOURCES INC /GA - Form 10-Q

AER ENERGY RESOURCES INC /GA

Form 10-Q

November 14, 2001

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

FORM 10-Q

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 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 ☒ No ☐

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

There were 25,522,121 shares of Common Stock outstanding as of October 19, 2001.

AER ENERGY RESOURCES, INC.  
FORM 10-Q  
FOR THE QUARTER ENDED SEPTEMBER 30, 2001

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## ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

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

	SEPTEMBER 30, 2001	SEPTEMBER 30, 2000
	(Unaudited)	(Unaudited)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 227,611	\$ 3,261
Accounts receivable	3,261	104,621
Inventories	104,621	260,561
Prepaid expenses and other current assets	260,561	
Total current assets	596,071	
Equipment and improvements	3,450,941	
Less accumulated depreciation	(3,213,921)	
	237,011	
Other assets	10,591	
<b>TOTAL ASSETS</b>	<b>\$ 843,671</b>	<b>\$ 3,261</b>
<b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>		
Current liabilities:		
Accounts payable	\$ 196,561	\$ 196,561
Deferred revenue		
Other accrued expenses	97,891	
Revolving credit note	500,001	
Convertible notes payable, net of discount of \$40,028	209,971	
Total current liabilities	1,004,431	
Redeemable convertible preferred stock, no par value, in series:		
Series A: authorized - 425,000 shares; 404,500 shares issued and outstanding at September 30, 2001 and December 31, 2000; liquidation preference and redemption price of \$4,321,070 as of September 30, 2001 (including \$276,070 undeclared dividends)	2,029,111	
Series B: authorized - 250,000 shares; 102,250 shares issued and outstanding at September 30, 2001; liquidation preference and redemption price of \$1,063,175 as of September 30, 2001 (including \$40,675 undeclared dividends)	687,831	
Series C: authorized - 250,000 shares; 102,250 shares issued and outstanding at September 30, 2001; liquidation preference and redemption price of \$1,045,508 as of September 30, 2001 (including \$23,008 undeclared dividends)	80,431	
Total liabilities and redeemable convertible preferred stock	3,801,821	
Stockholders' deficit:		
Preferred stock, no par value:		
Authorized - 10,000,000 shares; no shares issued and outstanding		
Common stock, no par value:		

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Authorized - 100,000,000 shares; 25,522,121 shares issued and outstanding at September 30, 2001 and 24,850,263 shares issued and outstanding December 31, 2000	70,148,57
Unearned stock compensation	(5,65
Deficit accumulated during the development stage	(73,101,07
Total stockholders' deficit	(2,958,14
TOTAL LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK, AND STOCKHOLDERS' DEFICIT	\$ 843,67
	=====

See notes to condensed financial statements.

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

	THREE MONTHS ENDED SEPTEMBER 30,		NINE M SEP
	2001	2000	2001
License fees and research and development revenues	\$ 71,875	\$ 107,813	\$ 287,5
Product sales	--	--	
Cost of product sales	--	--	
Gross margin on product sales	--	--	
	71,875	107,813	287,5
Costs and expenses:			
Research and development			
- related party	--	--	
- other	747,708	923,916	2,270,9
Marketing, general and administrative			
- related party	--	--	
- other	360,516	393,126	1,161,3
Total costs and expenses	1,108,224	1,317,042	3,432,3
Operating loss	(1,036,349)	(1,209,229)	(3,144,8
Interest income	2,526	7,659	11,1
Interest expense	(96,986)	--	(142,5
Interest expense - related parties	(1,847)	(110,441)	(1,8
Net loss	(1,132,656)	(1,312,011)	(3,278,0

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Accretion of redeemable preferred stock	(158,991)	(1,441)	(264,3
Redeemable preferred stock dividends	(102,771)	(3,034)	(268,4
	-----	-----	-----
Net loss attributable to common stock	\$ (1,394,418)	\$ (1,316,486)	\$ (3,810,8
	=====	=====	=====
Net loss per share (basic and diluted)	\$ (0.05)	\$ (0.05)	\$ (0.
	=====	=====	=====
Weighted average shares outstanding (basic and diluted)	25,518,860	24,850,263	25,229,5

See notes to condensed financial statements.

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

	NINE MONTH SEPTEMBER 2001 -----
OPERATING ACTIVITIES:	
Net loss	\$ (3,278,091)
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization	117,882
Amortization of unearned stock compensation	26,210
Amortization of discount on promissory notes	81,659
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	(444,996)
	-----
Net cash used in operating activities	(3,497,336)
INVESTING ACTIVITIES:	
Purchases of equipment and improvements	(31,477)
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	(31,477)
FINANCING ACTIVITIES:	
Proceeds from revolving credit note to related parties	500,000

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Issuance of convertible debentures, net of issuance costs	--
Proceeds from convertible notes payable	261,113
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	254,211
Issuance of redeemable convertible preferred stock, net of issuance costs	1,959,792
	-----
Net cash provided by financing activities	2,975,116
	-----
(Decrease) increase in cash and cash equivalents	(553,697)
Cash and cash equivalents at beginning of period	781,314
	-----
Cash and cash equivalents at end of period	\$ 227,617
	=====

### Supplemental disclosure of non-cash financing activities:

Conversion of the \$2.0 million promissory notes payable to related parties, net of unamortized discount, to redeemable convertible preferred stock

\$ --  
=====

Upon the resignation of one member of the Company's Board of Directors, 12,000 non-vested shares of common stock, issued under the 1993 Non-Employee Directors' Restricted Stock Award Plan, were forfeited and returned to authorized and unissued shares

\$ --  
=====

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 and nine month periods ended September 30, 2001 are not necessarily indicative of the results that may be expected for the year ended December 31, 2001 or any interim period.

#### 2. RECLASSIFICATION

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Due to the accounting for the beneficial conversion options included in the Series A Preferred Stock, Series B Preferred Stock, and Series C Preferred Stock (collectively "Preferred Stock"), in accordance with EITF 00-27, Application of EITF Issue No. 98-5 "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios" to Certain Convertible Instruments ("EITF 00-27"), the Preferred Stock and common stock balances have been reclassified from balances previously reported as of March 31, 2001 and June 30, 2001 as follows:

	March 31, 2001		June 30, 2001	
	As Reported	As Adjusted	As Reported	
	-----	-----	-----	
Series A Preferred Stock	\$ 3,487,110	\$ 3,390,496	\$ 3,598,318	\$
Series B Preferred Stock	\$ 728,014	\$ 646,599	\$ 759,743	\$
Series C Preferred Stock	\$ -	\$ -	\$ 385,720	\$
Common Stock	\$ 67,364,989	\$ 67,543,018	\$ 68,202,194	\$

The Company has accreted the discounts on Preferred Stock attributable to the beneficial conversion features similar to preferred stock dividends totaling \$158,991 in the quarter ended September 30, 2001. Included in this amount were immaterial amounts relating to the quarters ended March 31, 2001, and June 30, 2001. There was no impact on the loss per share attributable to common stock for the quarters ended March 31, 2001 or June 30, 2001. See further discussion of Preferred Stock in Note 4 of Notes to Condensed Financial Statements.

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### 3. 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 September 30, 2001 and December 31, 2000 of \$104,625 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

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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 its agreements with Duracell Inc. and Rayovac Corporation, 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 nine-month periods ended September 30, 2001 or 2000.

#### 4. PREFERRED STOCK AND WARRANT TRANSACTIONS

In accordance with the terms of the Series A Preferred Stock issued September 27, 2000, the initial conversion price of \$0.851 is subject to adjustment upon the issuance of common stock (or equivalents) at less than the current conversion price (as defined by the agreement). As a result of the issuance of Series B Preferred on February 27, 2001 discussed below, the transaction in April 2001 discussed in Note 5, and the issuance of Series C Preferred on June 1, 2001 discussed below, the conversion price was adjusted from \$0.851 to \$0.744. In accordance with EITF 00-27, the number of shares that would be received upon conversion based on the adjusted conversion price is compared to the number that would have been received prior to the adjustment. The excess number of shares multiplied by the fair market value on the commitment date (September 27, 2000) equals the

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intrinsic value that results from the adjustment, or the beneficial conversion option. This value is allocated from the original proceeds upon adjustment resulting in a discount on the preferred stock. The discount is then accreted over the remaining period until the mandatory redemption date (September 27, 2005). As a result of the adjustments above, a total discount of the Series A Preferred Stock of approximately \$0.43 million was recorded on the various dates of adjustment. The discount will be accreted from the dates of adjustment to the redemption date of the preferred stock and will result in a reduction of earnings available to common shareholders.

Additionally, the initial conversion price shall be subject to further adjustment upon the first anniversary of the original issue date based on the underlying common stock price. As a result of the decrease in the stock price, as of September 27, 2001, the conversion price of Series A Preferred Stock was reduced to \$0.554, in accordance with the terms of the Series A Preferred Stock agreement. This adjustment resulted in an additional beneficial conversion discount, similar to that discussed above, of approximately \$1.28 million. The resulting discount will be accreted over the remaining period until the mandatory redemption date (September 27, 2005).

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 Company's Chairman of the Board). The Series B Preferred may be converted, at the option of the holder, to common stock of the Company at any time at an initial conversion price of \$0.515 per



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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.

This warrant is exercisable for five years and entitles the holder to purchase up to 776,699 shares 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 is being 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.

As a result of the allocation of a portion of the proceeds to the Series B Warrants, the effective conversion price of the Series B Preferred is less than the fair market value of common stock on February 27, 2001, resulting in a beneficial conversion option of approximately \$0.08

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million. The resulting discount will be accreted over the remaining period until the mandatory redemption date (February 27, 2006).

Similar to the terms of Series A Preferred Stock discussed above, the terms of the Series B Preferred Stock issued February 27, 2001, provide that the initial conversion price of \$0.515 is subject to adjustment upon the issuance of common stock (or equivalents) at less than the current conversion price (as defined by the agreement). As a result of the issuance of the transaction in April 2001 discussed in Note 5, and the issuance of Series C Preferred on June 1, 2001 discussed below, the conversion price was adjusted from \$0.515 to \$0.494. In accordance with EITF 00-27, the number of shares that would be received upon conversion based on the adjusted conversion price is compared to the number that would have been received prior to the adjustment. The excess number of shares multiplied by the fair market value on the commitment date (February 27, 2001) equals the intrinsic value that results from the adjustment, or the beneficial conversion option. This value is allocated from the original proceeds upon adjustment resulting in a discount on the preferred stock. The discount is then accreted over the remaining period until the mandatory redemption date (February 27, 2006). As a result of the adjustments above, a total discount on the Series B Preferred Stock of approximately \$0.20 million was recorded on the various dates of adjustment.

On June 1, 2001, the Company issued 102,250 shares of Series C Convertible Preferred Stock ("Series C Preferred") and a warrant to purchase up to 982,891 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, FW AER II, L.P. The Series C Preferred may be converted, at the option of the holder, to common stock of the Company at any time at a conversion price of \$0.407 per share, subject to various possible adjustments. The Company may redeem the Series C Preferred at a price equal to \$10.00 per share plus all accrued and unpaid dividends; and it must be redeemed in June 2006, unless previously converted. Dividends accrue at the rate of 6.75% per annum, are cumulative and compound annually.

This warrant is exercisable for five years and entitles the holder to purchase up to 982,891 shares of common stock at an exercise price of \$0.425 per share, subject to various possible adjustments. The fair value for this warrant

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of \$0.61 million, or \$0.62 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 is being accreted to the Series C Preferred on a straight-line basis through the mandatory redemption date so that at such redemption date, the carrying amount of the Series C Preferred will equal the mandatory redemption value.

Similar to the discussion of Series B Preferred above, as a result of the allocation of a portion of the proceeds to the Series C Warrants, the effective conversion price of the Series C Preferred is less than the fair market value of common stock on June 1, 2001, resulting in a beneficial conversion option of approximately \$0.38 million. The resulting discount will be accreted over the remaining period until the mandatory redemption date (June 1, 2006).

### 5. NOTE PAYABLE, COMMON STOCK, AND WARRANT TRANSACTION

In April 2001, the Company signed a License and Development Agreement with Rayovac Corporation (the "Agreement"). Under the Agreement the Company is licensing its zinc-air battery technology to Rayovac and performing design and development work for Rayovac.

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Rayovac will own the technology developed under the Agreement and the Company will have rights to utilize that technology.

In connection with the Agreement, the Company issued to Rayovac 656,858 shares of Company common stock and a warrant to purchase up to 218,953 shares of common stock for a total purchase price, net of transaction fees, of \$0.27 million. The warrant is exercisable for four years and entitles the holder to purchase up to 218,953 shares of common stock at an exercise price of \$0.4567 per share, subject to various possible adjustments. The fair value for this warrant of \$0.74 million, or \$0.34 per share, was estimated at the date of grant using the Black-Scholes valuation model. Rayovac has certain rights to purchase additional shares of common stock and warrants as of the Phase III Notice Date, anticipated to be early 2002.

Additionally, the Company issued a \$250,000 non-interest bearing note payable. The note converts to the number of shares of common stock equal to \$250,000 divided by the lesser of the average closing price for the thirty days prior to the conversion or \$1.50. The principal on the note is payable in cash only upon the occurrence of specified events of default. The note will convert to common stock upon the Phase III Notice Date, anticipated to be early 2002. While the note has no stated interest rate, an interest rate of 15% was used to discount the note by \$0.03 million and will be amortized to interest expense over its expected life. Based upon the rate at which the note becomes convertible, an additional discount of \$0.07 million was recorded in accordance with Emerging Issues Task Force Topic No. 00-27, which will also be amortized to interest expense.

### 6. REVOLVING CREDIT TRANSACTION

In September 2001, the Company received \$500,000 under a \$1,000,000 revolving credit loan note issued to Elmwood Partners II. Interest on the unpaid balance is accruing at the prime rate plus 1% point. The principal and interest are payable no later than December 31, 2001 and will automatically convert to convertible preferred stock and warrants to purchase common stock if the Company issues additional preferred stock in 2001. The remaining \$500,000 was borrowed in October 2001.

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### 7. 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.

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### 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 revenue recognized under this agreement ceased in the third quarter of 2001.

In April 2001, the Company entered into the Agreement with Rayovac to explore the feasibility of certain products and to license AER Energy's proprietary technology and patents to Rayovac. The Agreement includes both a development program and a stock purchase. The development program consists of three phases, with all three phases currently expected to be completed in the first quarter of 2002. Under the Agreement, the Company will not be required to incur more than \$250,000 of its own expenses, although it may choose to do so.

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 September 30, 2001 and 2000

The Company generated \$0.07, and \$0.11 million of license fees and research and development revenues under the TLAS Agreement with Duracell during the three months ended September 30, 2001 and 2000, respectively.

Research and development expenses decreased 19% to \$0.75 million for the three months ended September 30, 2001 from \$0.92 million for the same period in 2000. This decrease resulted primarily from reduced travel, tooling, supplies, and direct materials expenses.

Marketing, general and administrative expenses decreased 8% to \$0.36 million for the three months ended September 30, 2001 from \$0.39 million for the same period in 2000. This decrease resulted primarily from lower personnel, travel, and investor relation expenses, offset by increased sample sales.

#### Nine Months Ended September 30, 2001 and 2000

The Company generated \$0.29 and \$0.32 million of license fees and research and development revenues under the TLAS Agreement with Duracell during the nine months ended September 30, 2001 and 2000, respectively.

Research and development expenses decreased 16% to \$2.27 million for the nine months ended September 30, 2001 from \$2.70 million for the same period in 2000. This decrease resulted primarily from reduced travel, tooling, supplies, and materials expenses.

Marketing, general and administrative expenses decreased 9% to \$1.16 million for the nine months ended September 30, 2001 from \$1.28 million for the same period in 2000. This decrease resulted primarily from decreased personnel and legal expenses.

#### LIQUIDITY, CAPITAL RESOURCES AND FINANCIAL CONDITION

As of September 30, 2001, the Company had cash and cash equivalents of \$0.23 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 September 2001, the Company received \$0.50 million in cash under the revolving credit loan note from Elmwood Partners II. The remaining \$0.50 million was borrowed in October 2001.

Net cash and cash equivalents used in operating activities decreased to \$3.50 million for the nine months ended September 30, 2001 from \$3.76 million for the same period in 2000 due primarily to the decrease in net loss offset by the net increase in operating assets and liabilities, primarily prepaid insurance.

Net cash and cash equivalents provided by financing activities for the nine months ended September 30, 2001 was \$2.98 million, arising from the revolving credit loan, the issuance of a note payable to Rayovac, and the issuance of redeemable convertible preferred stock and common stock. See further discussion in Notes 4 and 5 of Notes to Condensed Financial Statements. Net cash provided by financing activities for the same period in 2000 was \$3.94 million, arising from notes payable to related parties and issuance of preferred stock.

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The Company currently anticipates that its existing cash and cash equivalents balance, along with the funds available under the two revolving credit notes from Elmwood Partners II, will fund operations and continue technology development at the current level of activity through the fourth quarter of 2001. The Company will need to raise additional funds through additional debt or equity. There can be no assurance that additional 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 those described in "Forward Looking Statements" below 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 important factors, the risks and uncertainties which could cause actual results to differ materially from those anticipated, which include but are not limited to the following: the ability of the Company to achieve development goals, the ability of the Company to commercialize its battery technology, the ability of the Company to license its technology, development of competing battery technologies, the ability of the Company to protect its proprietary rights to its technology, improvements in conventional battery technologies, the demand for and acceptance of the Company's products in the marketplace, the ability to obtain commitments from battery manufacturers and OEMs, the impact of any future governmental regulations, the impact of pricing or material costs, the 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. All forward looking statements contained in this report are intended to be subject to the safe harbor 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".

### PART II - OTHER INFORMATION

#### ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

In September 2001 the Company borrowed \$0.50 million under a \$1.00

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million revolving credit loan note issued to Elmwood Partners II. The note will automatically convert to convertible preferred stock and warrants to purchase common stock if the Company issues additional preferred stock in 2001. The note will convert at the price for which such preferred stock and warrants are sold to third parties.

The issuance of this note 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. At the time of issuance, Elmwood Partners II was an accredited investor as defined under Regulation D. No general solicitation or advertising was used in connection with this issuance and an appropriate legend was placed on the note stating that it was not registered under the Securities Act.

This note is a debt obligation of the Company and is therefore superior to the Company's common stock as to payment 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

10.8	Revolving Credit Loan Note of AER Energy Resources, Inc., dated August 28, 2001 between Elmwood Partners II and AER Energy Resources, Inc.
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#### (B) REPORTS ON FORM 8-K:

The registrant did not file any reports on Form 8-K during the three months ended September 30, 2001.

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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.

AER ENERGY RESOURCES, INC.

Date: November 13, 2001 By: /s/ David W. Dorheim

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David W. Dorheim, President and  
Chief Executive Officer

Date: November 13, 2001 By: /s/ J.T. Moore

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

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