STEWART & STEVENSON SERVICES INC
Form 10-Q
August 28, 2001

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 JULY 28, 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 0-8493

STEWART & STEVENSON SERVICES, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

TEXAS (State or other jurisdiction of incorporation or organization)	74-1051605 (I.R.S. Employer Identification No.)
2707 NORTH LOOP WEST, HOUSTON, TEXAS (Address of principal executive offices)	77008 (Zip Code)

(713) 868-7700
(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 [ ]

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

COMMON STOCK, WITHOUT PAR VALUE (Class)	28,438,591 SHARES (Outstanding at August 7, 2001)

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

The following information required by Rule 10-01 of Regulation S-X is provided herein for Stewart & Stevenson Services, Inc. and Subsidiaries (the "Company"):

Consolidated Condensed Statements of Financial Position - July 28, 2001 and January 31, 2001.

Consolidated Condensed Statements of Earnings - Three and Six Months Ended July 28, 2001 and July 29, 2000.

Consolidated Condensed Statements of Cash Flows - Three and Six Months Ended July 28, 2001 and July 29, 2000.

Consolidated Condensed Statements of Comprehensive Income - Three and Six Months Ended July 28, 2001 and July 29, 2000.

Notes to Consolidated Condensed Financial Statements.

STEWART & STEVENSON SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF FINANCIAL POSITION
(IN THOUSANDS, EXCEPT SHARE DATA)

	JULY 28, 2001 (Unaudited)	JANUARY
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 107,764	$ 10
Accounts and notes receivable, net	199,513	17
Recoverable costs and accrued profits not yet billed	2,058	2
Inventories:		
Power Products	171,793	17
Petroleum Equipment	40,845	2
Airline Products	25,860	2
Tactical Vehicle Systems	6,633	
Other Business Activities	762	
Excess of current cost over LIFO values	(51,359)	(5
Total inventories, net	194,534	18
Prepaid and other current assets	15,714	1
TOTAL CURRENT ASSETS	519,583	50
PROPERTY, PLANT AND EQUIPMENT, NET	114,615	11

INVESTMENTS AND OTHER ASSETS	21,355	2
	$ 655,553	$ 63
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Notes payable	$ 10,469	$ 1
Accounts payable	53,073	6
Accrued payrolls and incentives	19,764	2
Current portion of long-term debt	437	2
Billings in excess of costs	52,735	3
Other current liabilities	39,734	3
TOTAL CURRENT LIABILITIES	176,212	18
COMMITMENTS AND CONTINGENCIES		
LONG-TERM DEBT	57,440	6
ACCRUED POSTRETIREMENT BENEFITS & PENSION	20,620	1
DEFERRED COMPENSATION	1,889	
OTHER LONG-TERM LIABILITIES	6,651	
TOTAL LIABILITIES	262,812	27
SHAREHOLDERS' EQUITY		
Common Stock, without par value, 100,000,000 shares authorized; 28,436,341 and 28,067,566 shares issued at July 28, 2001 and January 31, 2001, respectively	51,997	4
Currency translation adjustment	(1,015)	
Retained earnings	341,759	31
TOTAL SHAREHOLDERS' EQUITY	392,741	36
	$ 655,553	$ 63

SEE ACCOMPANYING NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS.

STEWART & STEVENSON SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF EARNINGS
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	SIX MONTHS ENDED		
	JULY 28, 2001	JULY 29, 2000	JULY
Sales	$ 731,910	$ 528,091	$
Cost of sales	625,408	440,888	
Gross profit	106,502	87,203	
Recovery of costs incurred, net	(20,800)	--	
Selling and administrative expenses	72,011	69,430	

Interest expense	3,758	4,356	
Interest and investment income	(2,112)	(4,592)	
Other (income) expense, net	(286)	(6,282)	
	52,571	62,912	
Earnings before income taxes	53,931	24,291	
Income tax expense	19,956	9,014	
Net earnings from continuing operations	33,975	15,277	
Loss on disposal of discontinued operations, net of tax of $372	(628)	--	
Net earnings	$ 33,347	$ 15,277	$
Weighted average shares outstanding:			
Basic	28,206	28,005	
Diluted	28,927	28,175	
Earnings per share:			
Basic			
Continuing operations	$ 1.20	$ 0.55	$
Loss on disposal of discontinued operations	(0.02)	--	
NET EARNINGS PER SHARE	$ 1.18	$ 0.55	$
Diluted			
Continuing operations	$ 1.17	$ 0.54	$
Loss on disposal of discontinued operations	(0.02)	--	
NET EARNINGS PER SHARE	$ 1.15	$ 0.54	$
Cash dividends per share	$ 0.170	$ 0.170	$

SEE ACCOMPANYING NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS.

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STEWART & STEVENSON SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)

	SIX MONTHS ENDED	
	JULY 28, 2001	JULY 29, 2
		(U
OPERATING ACTIVITIES		
Net earnings from continuing operations	$ 33,975	$ 15,27

Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Accrued postretirement benefits & pension	1,741	61
Depreciation and amortization	10,901	11,02
Deferred income taxes, net	(3,106)	(75
Gain on sale of business assets	--	(5,64
Change in operating assets and liabilities net of the effect of acquisition, divestiture and discontinued operations:		
Accounts and notes receivable, net	(29,612)	36,94
Recoverable costs and accrued profits not yet billed	20,357	(4,73
Inventories	(14,127)	15,95
Accounts payable	(13,364)	(37,83
Accrued payrolls and incentive	(1,630)	(4,33
Current income taxes, net	4,509	10,12
Other current liabilities	6,753	7,21
Other--principally long-term assets and liabilities	21,703	(4,37
NET CASH PROVIDED BY OPERATING ACTIVITIES	38,100	39,49
INVESTING ACTIVITIES		
Expenditures for property, plant and equipment	(22,819)	(20,55
Proceeds from sale of business assets	2,323	44,62
Disposal of property, plant and equipment, net	1,280	2,28
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	(19,216)	26,35
FINANCING ACTIVITIES		
Additions to long-term borrowings	--	20,04
Payments on long-term borrowings	(20,219)	(20,22
Net short-term borrowings (payments)	(2,142)	(10,72
Dividends paid	(4,776)	(4,76
Exercise of stock options	6,062	--
NET CASH USED IN FINANCING ACTIVITIES	(21,075)	(15,65
Increase (Decrease) in cash and cash equivalents	(2,191)	50,18
Cash and cash equivalents, beginning of period	109,955	11,71
Cash and cash equivalents, end of period	$ 107,764	$ 61,90
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Net cash paid during the period for:		
Interest	$ 4,101	$ 4,74
Income tax	18,377	7,20

SEE ACCOMPANYING NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS.

STEWART & STEVENSON SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME
(IN THOUSANDS)

	SIX MONTHS ENDED		THREE MONTHS
	(Unaudited)		(Unaudite
	JULY 28, 2001	JULY 29, 2000	JULY 28, 2001
Net earnings	$ 33,347	$ 15,277	$ 13,014
Currency translation loss	(86)	(179)	(22)
Comprehensive income	$ 33,261	$ 15,098	$ 12,992

SEE ACCOMPANYING NOTES TO THE CONSOLIDATED CONDENSED FINANCIAL STATEMENTS.

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STEWART & STEVENSON SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

NOTE A--BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

The accompanying consolidated condensed financial statements have been prepared in accordance with Rule 10-01 of Regulation S-X for interim financial statements required to be filed with the Securities and Exchange Commission and do not include all information and footnotes required by generally accepted accounting principles for complete financial statements. However, the information furnished herein reflects all normal recurring adjustments which are, in the opinion of management, necessary for a fair statement of the results for the interim periods. The results of operations for the three and six months ended July 28, 2001 are not necessarily indicative of the results that will be realized for the fiscal year ending January 31, 2002.

The Company's fiscal year begins on February 1 of the year stated and ends on January 31 of the following year. For example, the Company's fiscal year 2001 (hereinafter referred to as "2001") commenced on February 1, 2001 and ends on January 31, 2002. In addition, other years are referred to in the same manner. The Company reports results on the fiscal quarter method with each quarter comprising approximately 13 weeks.

The accounting policies followed by the Company in preparing interim consolidated financial statements are similar to those described in the "Notes to Consolidated Financial Statements" in the Company's January 31, 2001 Form 10-K. An actual valuation of inventory under the last-in-first-out ("LIFO") method can be made only at the end of each year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations are based on management's estimates of expected year-end inventory levels and costs. Interim results are subject to the final year-end LIFO inventory valuation.

The accompanying consolidated condensed financial statements for 2000 and related notes contain certain reclassifications to conform with the presentation used in 2001.

NOTE B--SEGMENT INFORMATION

Financial information relating to industry segments is as follows (in thousands except percentages):

	SIX MONTHS ENDED		THREE
	JULY 28, 2001	JULY 29, 2000	JULY 28, 2001
		(Unaudited)	
SALES			
Power Products	$ 384,771	$ 283,615	$ 217,099
Tactical Vehicle Systems	217,265	134,325	108,771
Petroleum Equipment	71,606	34,261	36,868
Airline Products	46,988	56,585	22,878
Other Business Activities	11,280	19,305	4,773
Total	$ 731,910	$ 528,091	$ 390,389
OPERATING PROFIT (LOSS)			
Power Products	$ 10,604	$ 2,417	$ 8,778
Tactical Vehicle Systems	54,706	28,957	16,361
Petroleum Equipment	3,595	(269)	2,208
Airline Products	(6,909)	(4,337)	(2,558)
Other Business Activities	333	2,632	107
Total	$ 62,329	$ 29,400	$ 24,896
OPERATING MARGIN PERCENTAGE			
Power Products	2.8%	0.9%	4.0%
Tactical Vehicle Systems	25.2	21.6	15.0
Petroleum Equipment	5.0	(0.8)	6.0
Airline Products	(14.7)	(7.7)	(11.2)
Other Business Activities	3.0	13.6	2.2
Total	8.5	5.6	6.4

A reconciliation of operating profit to earnings before income taxes is as follows (in thousands):

	SIX MONTHS ENDED		TH
	(Unaudited)		
	JULY 28, 2001	JULY 29, 2000	JULY 28,
Operating profit	$ 62,329	$ 29,400	$ 24,8
Corporate expenses, net	(6,753)	(5,345)	(3,5
Non-operating interest and investment income	2,112	4,592	8

Interest expense	(3,757)	(4,356)	(1,6
Earnings before income taxes	$ 53,931	$ 24,291	$ 20,5

NOTE C--ACCOUNTING PRONOUNCEMENTS

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting For Derivative Instruments and Hedging Activities." This statement establishes accounting and reporting standards for derivative instruments, including derivative instruments embedded in other contracts and hedging activities. Effective February 1, 2001, the Company adopted SFAS No. 133. Such adoption did not have a material effect on the Company's results of operations or financial position.

In September 2000, the Emerging Issues Task Force ("EITF") released abstract No. 00-10, "Accounting for Shipping and Handling Fees and Costs," which was adopted by the Company effective January 31, 2001. EITF No. 00-10 requires that shipping and handling costs billed to customers be recorded as sales. Accordingly, the Company has restated its quarterly sales and cost of sales for 2000. Such restatement had no impact on gross profit or net earnings.

In June 2001, the FASB issued SFAS No. 141 "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires that the purchase method of accounting be used for all business combinations entered into after June 30, 2001 and SFAS No. 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets. SFAS No. 142 requires that the balance sheet valuation of goodwill and other intangible assets be evaluated for impairment at least annually. Further, it requires that amortization of goodwill cease beginning with the Company's fiscal year 2002. Any transition charges recognized upon implementation of SFAS No. 142 will be accounted for as a cumulative effect of a change in accounting principle. The Company has approximately $14 million of unamortized goodwill and other intangible assets as of July 28, 2001, and expects to recognize approximately $600,000 of amortization expense associated therewith during Fiscal 2001. The Company is currently evaluating the possible impact of the adoption of these standards on its financial statements.

NOTE D--COMMITMENTS AND CONTINGENCIES

As a custom packager of power systems, the Company issues bid and performance guarantees in the form of performance bonds or standby letters of credit. Performance type letters of credit totaled $4.1 million at July 28, 2001.

The Company's government contract operations are subject to U.S. Government investigations of business practices and cost classifications from which legal or administrative proceedings can result. Based on government procurement regulations, under certain circumstances a contractor can be fined, as well as suspended or debarred from government contracting. In that event, the Company would also be unable to sell equipment or services to customers that depend on loans or financial commitments from the Export Import Bank, Overseas Private Investment Corporation, and similar government agencies during a suspension or debarment.

During 1998, the U.S. Customs Service detained a medium tactical vehicle that was being shipped by the Company for display in a European trade show. The Company has been advised that the U.S. Customs Service and the Department of Justice are investigating potential violations by the Company of laws relating to the export of controlled military vehicles, weapons mounting systems, and firearms. Such investigation could result in the filing of criminal, civil, or administrative sanctions against the Company and/or individual employees and could result in a suspension or debarment of the Company from receiving new contracts or subcontracts with agencies of the U.S. Government or the benefit of federal assistance payments. It is presently impossible to determine the actual costs that may be incurred to resolve this matter or whether the resolution will have a material adverse effect on the Company's results of operations.

The Company is also a defendant in a number of lawsuits relating to contractual, product liability, personal injury, and warranty matters

normally incident to the Company's business. No individual case, or group of cases presenting substantially similar issues of law or fact, involve a claim for damages which are material to the Company's financial statements or are expected to have a material effect on the manner in which the Company conducts its business. Although management has established reserves that it believes to be adequate in each case, an unforeseen outcome in such cases could have a material adverse impact on the results of operations in the period it occurs.

The Company has provided certain guarantees in support of its customers' financing of purchases from the Company in the form of both residual value and debt guarantees. The maximum exposure of the Company related to guarantees at July 28, 2001 is $5.4 million.

The Company leases certain additional property and equipment under lease arrangements of varying terms whose annual rentals are less than 1% of consolidated sales.

NOTE E--SUBSEQUENT EVENTS

In Fiscal 2000, the Company filed a certified claim with the U.S. Government seeking recovery of costs incurred by the Company resulting from retrofitting all vehicles produced under the first FMTV contract for changes in drive train components. All costs associated with the retrofitting were expensed by the Company as incurred. The U.S. Army and the Company agreed to attempt resolution through voluntary participation in the Alternative Disputes Resolution process managed by the Armed Services Board of Contract Appeals. This process took place in August 2001 and concluded with the agreement that the Company would receive $18.5 million in settlement of its claim. The Company has recorded the recovery and related receivable in August 2001. The U.S. Government has agreed to use its best efforts to effect payment by December 31, 2001. If payment is not made by December 31, 2001, the settlement shall be converted to a consent decree with interest accruing from January 1, 2002 until paid.

In August of 2001, management committed to a plan to restructure its Airline Products segment that includes relocation and consolidation of most of its products and workforce to Kennesaw, Georgia. Costs associated with the restructuring will be incurred primarily in the third and fourth quarters of Fiscal 2001.

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

This discussion should be read in conjunction with the attached condensed consolidated financial statements and notes thereto, and with the Company's Form 10-K and notes thereto for the fiscal year ended January 31, 2001. The following discussion contains forward-looking statements which are based on assumptions such as timing, volume, and pricing of customers' orders. In connection therewith, please see the cautionary statements contained therein and the heading labeled "Factors That May Affect Future Results" below, which identify important factors that could cause actual results to differ materially from those in the forward-looking statements.

The Company's fiscal year begins on February 1 of the year stated and ends on January 31 of the following year and the Company reports its results on a fiscal quarter basis, with each quarter being approximately 13 weeks long. For example, "Fiscal second quarter 2001" commenced on April 29, 2001 and ends on July 28, 2001.

RESULTS OF OPERATIONS

Sales for Fiscal second quarter 2001 grew 46% to $390.4 million compared to sales of $267.0 million in the same period a year ago. Gross profit percentage for the same period was 14.8%, slightly higher than the 14.3% recorded during Fiscal first quarter 2001 and the 14.5% recorded in last year's second quarter.

Sales for the first six months of Fiscal 2001 grew 39% to $731.9 million versus $528.1 million for the first six months of Fiscal 2000. This year's first six months includes special non-recurring items that impacted cost of goods sold by $5.1 million and which impacted gross profit by 0.7 percentage points. These adjustments pertained to accounts receivable, inventory realization, and higher warranty costs. Other factors impacting the gross margin comparison with last year include lower margins in the Airline Products segment and a return to more normal margins in the Tactical Vehicle Systems segment.

Recovery of costs incurred, net represented recovery pursuant to a certified claim with the U.S. Government for costs incurred by the Company resulting from production delays in the first multi-year Family of Medium Tactical Vehicles ("FMTV") contract. A settlement of $22.0 million was reached during Fiscal first quarter 2001 which was reduced by $1.2 million of related expenses for legal and professional services.

Selling and Administrative expenses were $36.5 million, or 9.4% of sales for Fiscal second quarter 2001 compared to $35.5 million or 10.4% of sales in Fiscal first quarter of 2001 and $30.6 million or 11.5% in Fiscal second quarter 2000. Selling and Administrative expenses for the first six months of Fiscal 2001 were $72.0 million, or 9.8% of sales compared to $69.4 million, or 13.2% for the same period in the prior year. The first six months of Fiscal 2001 included special non-recurring items of $1.5 million pertaining to legal expenses and provisions for a doubtful receivable. The first six months of Fiscal 2000 included a $7.0 million provision for a doubtful receivable.

Interest and investment income more than doubled to $0.9 million in the Fiscal second quarter 2001 compared to $0.4 million for Fiscal second quarter 2000 due to higher average cash and investment balances, partially offset by lower effective interest rates. Interest and investment income decreased $2.5 million during the first six months of Fiscal 2001 to $2.1 million compared to $4.6 million in the previous year. Included in the previous year's results was $4.0 million in interest income in connection with tax refunds from the Internal Revenue Service. Interest expense decreased $0.3 million principally due to lower average borrowings.

Other income in Fiscal 2000 second quarter and six months results included a $5.6 million gain from sale of the gas compression leasing business.

Net earnings from continuing operations in Fiscal second quarter 2001 were $13.0 million or $0.45 per diluted share versus $7.8 million or $0.27 per share in last year's second quarter. Net earnings from continuing operations for the first half more than doubled to $33.9 million or $1.17 per share compared to $15.3 million or $0.54 per diluted share in the same period for Fiscal 2000. Net loss from discontinued operations in the first half of Fiscal 2001 was $ 0.6 million or $0.02 per share. Total net earnings in Fiscal second quarter 2001 were $33.3 million or $1.15 per diluted share compared with $15.3 million or $0.54 per share for the comparable period of Fiscal 2000.

SEGMENT DATA

The Company's management analyzes financial results in five business segments based on distinct product and customer types: Power Products, Tactical Vehicle Systems, Petroleum Equipment, Airline Products, and Other Business Activities. Such segments are described below along with analyses of their respective results of operations.

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The Power Products segment, which is responsible for marketing and aftermarket support of a wide range of industrial equipment, recorded Fiscal second quarter 2001 sales of $217.1 million, a 40% increase over sales of $155.3 million in the same period of last year. The sales growth was paced by $40 million in revenue for two turnkey power generation projects that are part of the California Independent System Operation ("ISO") Summer Reliability Program. Operating profit totaled $8.8 million versus $3.2 million in the comparable period of last year. The operating profit rate in Fiscal second quarter 2001 improved to 4.0 percent as compared to 2.1 percent in last year's second quarter as a result of product mix and productivity improvements. Last year's second quarter included a $2.5 million increase in reserves primarily for inventories.

The Tactical Vehicle Systems segment, which manufactures tactical vehicles for the U.S. Army and others, recorded sales of $108.8 million in the Fiscal second quarter 2001 compared to $55.7 million a year ago. Operating profit for the quarter totaled $16.4 million, compared with $14.3 million in the Fiscal second quarter 2000. In Fiscal 1998, the Company filed a claim with the U.S. government seeking recovery of costs incurred resulting from delays from the original production plan in the first multi-year FMTV contract. The U.S. Army and the Company participated in a voluntary dispute resolution process which took place in April 2001 and resulted in a $22.0 million settlement which was included in Fiscal first quarter 2001 results. Operations in Fiscal first quarter 2001 also included special non-recurring items of $1.7 million, principally related to this cost recovery. Margin rates for this segment are anticipated to be somewhat lower in the third quarter due to sales mix, principally resulting from option sales that carry lower prices. A rebound in margin rates is expected in the fourth quarter.

The Petroleum Equipment segment manufactures equipment for the oil and gas exploration, production, and well stimulation industries. Sales in this segment totaled $36.9 million for Fiscal second quarter 2001 compared to $18.8 million in the same period of Fiscal 2000. Operating profit for the second quarter was $2.2 million versus a profit of $0.4 million in the previous year. The order backlog at the end of the second quarter totaled $63.0 million, compared with $47.4 million at the end of Fiscal 2000. Demand for this segment's products remains strong and the Company anticipates improvements in profit margin achieved in the second quarter to continue into the second half of fiscal 2001.

The Airline Products segment, which manufactures airline ground support products and mobile railcar movers, recorded sales of $22.9 million in Fiscal second quarter 2001, compared with $28.3 million in the same quarter last year. Operating loss for the second quarter totaled $2.6 million, an improvement from the first quarter loss of $4.4 million and last year's second quarter loss of $4.3 million. Operations in Fiscal first quarter 2001 included the impact of special non-recurring items of $3.1 million related to higher costs for extended warranties and expenses for inventory realization. The performance improvement team, established earlier this year, continues to make progress and improved margins are expected during the second half of Fiscal 2001 before any costs associated with the rationalization of the segment's manufacturing facilities. - See "Subsequent Events" below.

Other business activities not identified in a specific segment include predominantly gas compression equipment sales. Fiscal second quarter 2001 sales were $4.8 million, compared to $8.9 million for the comparable period last year. The decline in sales year over year was principally due to the exiting of the gas compression leasing business last year. Second quarter operating profit was $0.1 million compared to $3.3 million in last year's second quarter, which included a $5.6 million gain on sale of the gas compression leasing business.

UNFILLED ORDERS

The Company's unfilled orders consist of written purchase orders, letters of intent, and oral commitments. These unfilled orders are generally subject to cancellation or modification due to customer relationships or other conditions. Purchase options are not included in unfilled orders until exercised. Unfilled orders as of July 28, 2001 and as of July 29, 2000 were as follows:

	July 28, 2001	July 29, 2000
	(In millions)	
Tactical Vehicle Systems	$ 493.1	$ 795.7
Power Products	146.1	116.7
Petroleum Equipment	63.0	55.6
Airline Products	17.1	17.2
All Other	10.6	10.1
	$ 729.9	$ 995.3

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Total unfilled orders decreased $115.3 million during the quarter principally as a result of deliveries under the multi-year Tactical Vehicle Systems contract and completion of two turnkey power generation projects in California in the Power Products segment. The Petroleum Equipment segment's unfilled orders increased $15.6 million during the quarter due to certain large orders received.

Over the coming months, the Company expects the backlog in its Tactical Vehicle Systems segment to continue to decrease as existing contractual orders are filled.

LIQUIDITY AND CAPITAL RESOURCES

During Fiscal second quarter 2001, cash of $40.4 million was provided by operations which included a $22.0 million recovery from the U.S. Government. During the same period, the Company invested $10.7 million in property, plant and equipment to expand its existing businesses and for the purchase and implementation of its new enterprise information system. Payments of cash dividends on common stock totaled $2.4 million during the quarter. Cash and equivalents were $107.8 million at July 28, 2001, an increase of $11.9 million versus the prior quarter. Borrowings at the end of the Fiscal second quarter were $68.3 million, a decrease of $30.3 million versus the previous quarter. The decrease in debt was due to a scheduled repayment of $20.0 million and $8.9 million mortgage note reduction in connection with the sale of the remaining partnership interest in the corporate headquarters building.

The Company's sources of cash liquidity included cash and equivalents, cash from operations, amounts available under credit facilities, and other external sources of funds. The Company believes that these sources are sufficient to fund the current requirements of working capital, capital expenditures, dividends, and other financial commitments. The Company has in place an unsecured revolving debt facility that could provide up to approximately $145 million, net of $5 million outstanding under a $25 million letter of credit sub facility. This revolving facility matures during Fiscal 2004. In addition, the Company has $55 million in senior notes outstanding.

The Company's unsecured long-term notes, which include the revolving credit notes and senior notes, were issued pursuant to agreements containing covenants that restrict indebtedness, guarantees, rentals, and other items. Additional covenants in the revolving credit notes require the Company to maintain a minimum tangible net worth and interest coverage. Since these requirements are calculated from earnings and cash flow, dividends could be restricted indirectly. Dividends at the current level are not restricted as of the date of this report.

The Company has additional banking relationships which provide uncommitted borrowing arrangements. In the event that any acquisition of additional operations, growth in existing operations, settlements of lawsuits or disputes, changes in inventory levels, accounts receivable, tax payments, or other working capital items create a permanent need for working capital or capital expenditures in excess of the existing cash and equivalents and committed lines of credit, the Company may seek to borrow under other long-term financing instruments or seek additional equity capital.

SUBSEQUENT EVENTS

In Fiscal 2000, the Company filed a certified claim with the U.S. Government seeking recovery of costs incurred by the Company resulting from retrofitting all vehicles produced under the first FMTV contract for changes in drive train components. All costs associated with the retrofitting were expensed by the Company as incurred. The U.S. Army and the Company agreed to attempt resolution through voluntary participation in the Alternative Disputes Resolution process managed by the Armed Services Board of Contract Appeals. This process took place in August 2001 and concluded with the agreement that the Company would receive $18.5 million in settlement of its claim. The Company has recorded the recovery and related receivable in August 2001. The U.S. Government has agreed to use its best efforts to effect payment by December 31, 2001. If payment is not made by December 31, 2001, the settlement shall be converted to a consent decree with interest accruing from January 1, 2002 until paid.

In August of 2001, management committed to a plan to restructure its Airline Products segment that includes relocation and consolidation of most of its products and workforce to Kennesaw, Georgia. Costs associated with the restructuring will be incurred primarily in the third and fourth quarters of Fiscal 2001.

FACTORS THAT MAY AFFECT FUTURE RESULTS

FORWARD-LOOKING STATEMENTS

This filing contains forward-looking statements that are based on management's current expectations, estimates, and projections. These statements are not guarantees of future performance and involve a number of risks, uncertainties, and assumptions and are made pursuant to the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995. Many factors, including those discussed more fully elsewhere in this release and in the Company's filings with the Securities and Exchange Commission, particularly its latest annual report on Form 10-K, as well as others, could cause results to differ materially from those stated. Specific important factors that could cause actual results, performance, or achievements to differ materially from such forward-looking statements include risk of competition, risks relating to technology, risks of general economic conditions, risks relating to personnel, risks of dependence on government, inherent risks of government contracts, risks of claims and litigation, risks as to global trade matters, risks as to cost controls, risks as to acquisitions, risks as to currency fluctuations, risks as to environmental and safety matters, and risks as to distributorships, all as more specifically outlined in the Company's latest annual report on Form 10-K. In addition, such forward-looking statements could be affected by general industry and market conditions and growth rates, general domestic and international conditions including interest rates, inflation and currency exchange rates and other future factors. Actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

During 1998, the U.S. Customs Service detained a medium tactical vehicle that was being shipped by the Company for display in a European trade show. The Company has been advised that the U.S. Customs Service and the Department of Justice are investigating potential violations by the Company of laws relating to the export of controlled military vehicles, weapons mounting systems, and firearms. Such investigation could result in the filing of criminal, civil, or administrative sanctions against the Company and/or individual employees and could result in a suspension or debarment of the Company from receiving new contracts or subcontracts with agencies of the U.S. Government or the benefit of federal assistance payments.

The Company is also a defendant in a number of lawsuits relating to contractual, product liability, personal injury, and warranty matters normally incident to the Company's business. No individual case, or group of cases presenting substantially similar issues of law or fact, involve a claim for damages which are material to the Company's financial statements or are expected to have a material effect on the manner in which the Company conducts its business. Although management has established reserves that it believes to be adequate in each case, an unforeseen outcome in such cases could have a material adverse impact on the results of operations in the period it occurs.

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

On June 12, 2001 the Company's Annual Meeting of Shareholders was held. Set forth below is a brief description of each matter acted upon at the meeting and the number of votes cast for, against or withheld and abstaining, or not voting as to each matter.

ELECTION OF DIRECTORS	FOR	WITHHELD	ABSTAINED
Donald E. Stevenson	24,937,415	377,150	
Robert S. Sullivan	24,937,617	376,948	
Max L. Lukens	24,927,817	386,848	
Ratification of Accountants	24,993,503	317,082	3,980

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits:

3.2 Sixth Restated Bylaws of Stewart & Stevenson Services, Inc., effective June 12, 2001

(b) Form 8-K Report Date - May 9, 2001 (First Quarter Conference Call and Earnings Release Schedule)
Items reported - Item 5. Other Events
Item 7. Exhibits

Form 8-K Report Date - May 24, 2001 (First Quarter 2001 Financial Results)
Items reported - Item 5. Other Events
Item 7. Exhibits

Form 8-K Report Date - June 13, 2001 (Announces Two New Directors and Second Quarter Dividend)
Items reported - Item 5. Other Events
Item 7. Exhibits

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 on the 28th day of August 2001.

STEWART & STEVENSON SERVICES, INC.

By: /s/ MICHAEL L. GRIMES
Michael L. Grimes
President and Chief Executive Officer
(Principal Executive Officer)

By: /s/ JOHN H. DOSTER
John H. Doster
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

By: /s/ JOHN B. SIMMONS
John B. Simmons
Controller and Chief Accounting Officer
(Chief Accounting Officer)