

AAI Corp.

AAI Corp., a subsidiary of
United Industrial Corporation (NYSE:UIC)
570 Lexington Ave.
New York, NY 10022
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Website: <http://www.unitedindustrial.com>

Employees: 1,500
Revenue: \$238,500,000
Net Income: \$5,400,000
Assets: \$252,500,000
Liabilities: \$132,100,000
(As of December 31, 2001 of UIC)

Description: AAI makes training and simulation systems, automatic test equipment, unmanned aerial vehicle systems, ordnance systems, and mechanical support systems; military accounts make up 77% of its sales.

Asbestos Discussion from SEC filings:

From the Company's Form 10-Q for the quarter ended March 31, 2003

http://www.sec.gov/Archives/edgar/data/101271/000090951803000297/jd5-15_10q.txt

Filed On: May 15, 2003

The Company is involved in various lawsuits and claims, including asbestos related litigation and one environmental matter. Except as set forth below, there have been no material changes in litigation since the Company filed its annual report on Form 10-K for the year ended December 31, 2002, and except as set forth below, management believes that the ultimate amount of liability, if any, under the pending litigation will not have a materially adverse effect on the Company's financial position, results of operations or cash flows.

Detroit Stoker Company (Detroit Stoker), a wholly owned subsidiary of the Company, was notified in March 1992 by the Michigan Department of Natural Resources (MDNR) that it is a potentially responsible party in connection with the cleanup of a former industrial landfill located in Port of Monroe, Michigan. MDNR is treating the Port of Monroe landfill site as a contaminated facility within the meaning of the Michigan

Environmental Response Act (MERA). Under MERA, if a release or a potential release of a discarded hazardous substance is or may be injurious to the environment or to the public health, safety, or welfare, MDNR is empowered to undertake or compel investigation and response activities in order to alleviate any contamination threat. Detroit Stoker intends to aggressively defend these claims. At this time, no estimate can be made as to the amount or range of potential loss, if any, to Detroit Stoker with respect to this action, or whether MDNR will proceed.

UIC and its Detroit Stoker subsidiary have been named as defendants in asbestos-related personal injury litigation. Neither UIC nor Detroit Stoker fabricated, milled, mined, manufactured or marketed asbestos. The Company stopped the use of asbestos-containing materials in connection with its products in 1981.

The litigation is pending in Michigan, Mississippi, New York, North Dakota and Wisconsin. During 2002 UIC and Detroit Stoker experienced a significant increase in the volume of asbestos bodily-injury claims. As of April 30, 2003, the Company has received notice that it has been named as a defendant in 485 active cases involving approximately 18,463 asbestos bodily injury claimants, of which about 450 cases involving some 18,400 claimants were filed before January 1, 2003. Most of these lawsuits do not include specific dollar claims for damages, and many include a number of plaintiffs and multiple defendants. Based on historical data and the large increase in claimants over and above the projected incidence of disease relative to the Company's products, management believes the claimants in the vast majority of these cases will not be able to demonstrate that they have been exposed to the Company's asbestos-containing products or suffered any compensable loss as a result of such exposure. The direct asbestos-related expenses of the Company for defense and indemnity for the past five years was not material. During 2002, the Company engaged a consulting firm (Asbestos Consultant) with expertise in evaluating asbestos bodily-injury claims to work with the Company to project the amount that the Company would pay for its asbestos-related liabilities and defense costs. The methodology employed by the Consultant to project the Company's asbestos-related liabilities and defense costs is primarily based on (1) estimates of the labor force exposed to asbestos in the Company's products, (2) epidemiological modeling of asbestos-related disease manifestation, and (3) estimates of claim filings and settlement and defense costs that may occur in the future. The Company's limited claims history was not a significant variable in developing the estimates because such

history was not significant as compared to the number of claims filed in 2002.

Also in 2002, the Company retained another consultant (Insurance Consultant) to work with the Company to project its insurance coverage, including a non-binding sharing agreement with certain of its primary insurance carriers that has been in effect for approximately five years. The Insurance Consultant has prepared a report evaluating the Company's potential insurance coverage for defense costs and indemnification for asbestos bodily-injury claims. The Insurance Consultant's conclusion was primarily based on a review of the Company's coverage history, application of reasonable assumptions on the allocation of coverage consistent with industry standards, an assessment of the creditworthiness of the insurance carriers, experience and a review of the report of the Asbestos Consultant.

Based on these assumptions, other variables, and the reports of both the Asbestos and Insurance Consultants that were completed during the first quarter of 2003, the Company recorded a reserve for its bodily injury liabilities for asbestos-related matters through 2012 in the amount of \$31,852,000 as of December 31, 2002, including damages and defense costs. The Company also recorded an estimated insurance recovery as of December 31, 2002 of \$20,343,000 reflecting the estimate determined to be probable of being available to mitigate the Company's potential asbestos liability through 2012. These amounts remained unchanged during the first quarter of 2003.

Management has concluded that consideration of asbestos-related activity through 2012 represents a period for which a reasonable and reliable forecast of liability and insurance recoveries can be projected. That conclusion is based upon a number of factors, including 1) the

uncertainties inherent in estimating asbestos claims, payments and insurance recoveries, 2) knowledge that prior to 2002 the number of claims filed against the Company and the related average settlement costs were not significant, and 3) consultations with the Asbestos and Insurance Consultants. Accordingly, the net provision does not take into account either asbestos liabilities or insurance recoveries for any period past 2012.

The Company believes that its ultimate net asbestos-related contingent liability (i.e., its indemnity or other claim disposition costs plus related legal fees less insurance recoveries) cannot be estimated with certainty. Projecting future events, such as the number of new claims expected to be filed each year, the average cost of resolving each claim, coverage issues among layers of insurers and the continuing solvency of various insurance companies is subject to many uncertainties which could cause the actual liabilities and insurance recoveries to be higher or lower than those recorded or projected, and such differences could be material. Moreover, were Federal tort reform legislation to be enacted, the assumptions used in determining the potential liability could be materially impacted.

After considering the efforts of both consultants and based upon the facts as now known, including the reasonable possibility that claims will be received and paid over the next 50 year period, the Company's management believes that although asbestos claims could have a material adverse effect on the Company's financial condition or result of operations in a particular reporting period, asbestos claims should not have a material adverse effect on the Company's long term financial condition, liquidity or results of operations.

No assurance can be given, however, as to the actual amount of the Company's liability for such present and future claims or insurance recoveries, and the differences from estimated amounts could be material.

The Company is involved in various other lawsuits and claims, including a certain other environmental matter, arising out of the normal course of its business. In the opinion of management, the ultimate amount of liability, if any, under pending litigation, including claims described above, will not have a material adverse effect on the Company's financial position, results of operations or cash flows.

In connection with certain of its contracts, the Company commits to certain performance guarantees. The ability of the Company to perform under these guarantees may, in part, be dependent on the performance of other parties, including partners and subcontractors. If the Company is unable to meet these performance obligations, the performance guarantees could have a material adverse effect on product margins and the Company's results of operations, liquidity or financial position. The Company monitors the progress of its partners and subcontractors and does not believe that their performance will adversely affect these contracts as of March 31, 2003.

In connection with the discontinued transportation operations, AAI Corporation (AAI), a wholly owned subsidiary of the Company, has guaranteed certain performance criteria associated with the contractual obligations of ETI, a company owned 35% by AAI and 65% by Skoda, a.s. (Skoda), a Czech Republic company. The ability of ETI to perform under these contracts may, in

part, be dependent on the performance of other parties, including AAI, Skoda and other subcontractors. Thus, the ability to timely perform under these contacts may be outside AAI's control. In addition, while its operating affiliates performed under their contracts during the year, during 2001 Skoda declared bankruptcy.

During 2002, the transportation segment recorded 100% of the ETI loss because of Skoda's inability to meet its financial obligations under ETI's shareholder agreement. The additional losses recorded by the Company for Skoda's 65% share of ETI totaled \$17,264,000 during 2002 and \$124,000 during the first quarter of 2003. If Skoda is required to provide ETI with additional funding beyond the amounts already provided for by AAI on Skoda's behalf and it fails to do so, or if ETI is unable to meet its performance obligations, the performance guarantees by AAI could have a material adverse effect on the Company's results of operations, liquidity or financial condition. AAI monitors the progress of Skoda and ETI's other subcontractors.

In February 2000, the Czech Export Bank (CEB) approved credit facilities to ETI and two Skoda subsidiaries in order to finance the design and manufacture of electric trolley buses for the city and county of San Francisco (MUNI). These credit facilities which were repaid during 2002 were partially guaranteed by the Czech Government's Export Guarantee and

From the Company's Form 10-K for the period ended December 31, 2002
Filed On: March 31, 2003

Detroit Stoker was notified in March 1992 by the Michigan Department of Natural Resources ("MDNR") that it is a potentially responsible party in connection with the clean-up of a former industrial landfill

Insurance Corporation (EGAP). In addition, the Company previously agreed to assume joint and several liability on a progress payment bond totaling approximately \$22,000,000 at December 31, 2002. In January 2003, this bond was reduced to \$9,100,000. This progress payment bond is expected to be eliminated when the MUNI customer accepts certain deliveries during 2003. Although the Company has accepted full responsibility under the progress payment bond, Skoda retains its 65% obligation that is partially guaranteed by EGAP. In addition, previously existing bonds that guarantee performance under the MUNI contract obligate the Company to indemnify the surety, if necessary, for up to approximately \$33,000,000. These bonds as well as the Company's related indemnification obligations are expected to be released upon ETI's issuance of a warranty bond. The Company has previously agreed to indemnify the surety up to 35% of the warranty bond amount when such bond is issued. Although AAI may provide funds to ETI on a temporary basis it is expected that ETI will have sufficient working capital to complete the MUNI program.

The Dayton electric trolley buses contract required a performance bond of about \$16,000,000 that was outstanding at December 31, 2002. The Company was jointly and severally liable. In February 2003, the Company was released from this \$16,000,000 bond.

located in Port of Monroe, Michigan. MDNR is treating the Port of Monroe landfill site as a contaminated facility within the meaning of the Michigan Environmental

Response Act ("MERA"). Under MERA, if a release or a potential release of a discarded hazardous substance is or may be injurious to the environment or to the public health, safety, or welfare, MDNR is empowered to undertake or compel investigation and response activities in order to alleviate any contamination threat. Detroit Stoker intends to aggressively defend these claims. At this time, no estimate can be made as to the amount or range of potential loss, if any, to Detroit Stoker with respect to this action.

Reference is made to the information concerning asbestos litigation set forth in the section entitled "Management's Discussion

Asbestos Discussion from SEC filings:

From the Company's Form 10-Q for the quarter ended September 30, 2002

http://www.sec.gov/Archives/edgar/data/101271/000090951802000817/jd11-14_10q.txt

Filed On: November 14, 2002

The Company is involved in various lawsuits and claims, including asbestos related litigation and one environmental matter. Except as set forth below, there have been no material changes in litigation since the Company filed its annual report on Form 10-K for the year ended December 31, 2001, and except as set forth below, management believes that the ultimate amount of liability, if any, under the pending litigation will not have a materially adverse effect on the Company's financial position, results of operations or cash flows.

Like hundreds of other industrial companies, UIC and its Detroit Stoker subsidiary have been named as two of many defendants in asbestos-related personal injury litigation. The litigation is pending in Louisiana, Michigan, Mississippi, Ohio, New York and North Dakota. As of October 31, 2002, the Company was a named defendant in approximately 335 active cases involving approximately 9,500 claimants. Approximately 8,300 of those claims,

and Analysis of Financial Condition and Results of Operations" in the Annual Report, which information is incorporated herein by reference.

The Company is involved in various other lawsuits and claims, including certain other environmental matters, arising out of the normal course of its business. In the opinion of management, the ultimate amount of liability, if any, under pending litigation, including claims described above, will not have a materially adverse effect on the Company's financial position, results of operations or cash flows.

including all of the cases naming UIC, have been filed since September 1, 2002 and a majority of such claims were filed in October 2002. Neither UIC nor Detroit Stoker fabricated, milled, mined, manufactured or marketed asbestos. The Company stopped the use of asbestos-containing materials in connection with its products sometime in 1981. Management believes that the claimants in the vast majority of cases cannot demonstrate that they have been exposed to the Company's asbestos-containing products or suffered any compensable loss as a result of such exposure. The direct asbestos-related expenses of the Company for defense and indemnity for at least the past five years total about \$467,000, net of insurance proceeds.

Due to this recent increased volume of asbestos related bodily-injury claims, the Company has engaged a consulting firm (the "Consultant") with expertise in evaluating such claims to evaluate

the Company's potential asbestos liability. The Consultant's analysis is expected to be completed by the end of the fourth quarter of 2002. Because the Consultant's analysis is in its preliminary stages, the Company does not presently have an estimate upon which it can reasonably rely as to potential financial exposure for purposes of recording a provision for such a potential liability.

While it is uncertain as to the timing of when asbestos claims will be received, portions of the claims might not be received and paid for 50 or more years. After

considering anticipated insurance proceeds and based upon the facts as now known, the Company's management believes that although asbestos claims could have a material adverse effect on the Company's financial condition or results of operations in a particular financial reporting period, asbestos claims will not have a material adverse effect on the Company's long-term financial condition, liquidity or results of operations. No assurances can be given, however, as to the actual amount of the Company's liability for such present and future claims or insurance recoveries.

Asbestos Discussion from SEC filings:

From the Company's Form 10-Q for the period ended June 30, 2002

http://www.sec.gov/Archives/edgar/data/101271/000090951802000598/mv8-12_10q.txt

Filed On: August 12, 2002

The Company is involved in various lawsuits and claims, certain of which relate to asbestos and other environmental matters. Management believes that the ultimate amount of liability, if any, under the pending litigation will not have a

materially adverse effect on the Company's financial position, results of operations or cash flows. There have been no material changes in this litigation from December 31, 2001. (See Item 3 - Form 10-K for December 31, 2001.)

Asbestos Discussion from SEC filings:

From the Company's Form 10-Q for the quarter ended March 31, 2002

http://www.sec.gov/Archives/edgar/data/101271/000090951802000398/mv5-15_q.txt

Filed On: May 15, 2002

The Company is involved in various lawsuits and claims, including various environmental matters. In the opinion of management, the ultimate amount of liability, if any, under the pending litigation will not have a materially adverse effect on

the Company's financial position, results of operations or cash flows. There have been no material changes in this litigation from December 31, 2001. (See Item 3 - Form 10-K for December 31, 2001).

Asbestos Discussion from SEC filings:

From the Company's Form 10-K for the period ended December 31, 2002

<http://www.sec.gov/Archives/edgar/data/101271/000114544302000052/d10928.txt>

Filed On: April 1, 2002

Detroit Stoker was notified in March 1992 by the Michigan Department of Natural Resources ("MDNR") that it is a potentially responsible party in connection with the clean-up of a former industrial landfill located in Port of Monroe, Michigan. MDNR is treating the Port of Monroe landfill site as a contaminated facility within the meaning of the Michigan Environmental Response Act ("MERA"). Under MERA, if a release or a potential release of a discarded hazardous substance is or may be injurious to the environment or to the public health, safety, or welfare, MDNR is empowered to undertake or compel investigation and response activities in order to alleviate any

contamination threat. Detroit Stoker intends to aggressively defend these claims. At this time, no estimate can be made as to the amount or range of potential loss, if any, to Detroit Stoker with respect to this action.

The Company is involved in various other lawsuits and claims, including certain other environmental matters, arising out of the normal course of its business. In the opinion of management, the ultimate amount of liability, if any, under pending litigation, including claims described above, will not have a materially adverse effect on the Company's financial position, results of operations or cash flows.

Asbestos Discussion from SEC filings:

From the Company's Form 10-Q for the quarter ended September 30, 2001

<http://www.sec.gov/Archives/edgar/data/101271/000090951801500432/uicq.txt>

Filed On: November 14, 2001

The Company is involved in various lawsuits and claims, including various environmental matters. In the opinion of management, the ultimate amount of liability, if any, under the pending litigation will not have a materially

adverse effect on the Company's financial position, results of operations or cash flows. There have been no material changes in this litigation from December 31, 2000. (See item 3 - Form 10-K for December 31, 2000).

Asbestos Discussion from SEC filings:

From the Company's Form 10-Q for the quarter ended June 30, 2001

<http://www.sec.gov/Archives/edgar/data/101271/000090951801500238/mv-10q.txt>

Filed On: August 14, 2001

The Company is involved in various lawsuits and claims, including various environmental matters. In the opinion of management, the ultimate amount of liability, if any, under the pending litigation will not have a materially adverse effect on

the Company's financial position, results of operations or cash flows. There have been no material changes in this litigation from December 31, 2000. (See item 3 - Form 10-K for December 31, 2000).

Asbestos-Related News:

[AAI Becomes Indirect Victim of Asbestos \(Published January 10, 2003\)](#)