STEWART & STEVENSON SERVICES INC
Form 10-Q
December 11, 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 OCTOBER 27, 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)	28,444,281 SHARES (Outstanding at November 30, 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 - October 27, 2001 and January 31, 2001.

Consolidated Condensed Statements of Earnings - Nine and Three Months Ended October 27, 2001 and October 28, 2000.

Consolidated Condensed Statements of Cash Flows - Nine and Three Months Ended October 27, 2001 and October 28, 2000.

Consolidated Condensed Statements of Comprehensive Income - Nine and Three Months Ended October 27, 2001 and October 28, 2000.

Notes to Consolidated Condensed Financial Statements.

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

	OCTOBER 27, 2001 (Unaudited)	JANUA
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 82,732	$
Accounts and notes receivable, net	224,886	
Recoverable costs and accrued profits not yet billed	2,596	
Inventories	257,182	
Excess of current cost over LIFO values	(50,495)	
Other current assets	16,817	

TOTAL CURRENT ASSETS	533,718	
PROPERTY, PLANT AND EQUIPMENT, NET	122,058	
INVESTMENTS AND OTHER ASSETS	22,018	
	$ 677,794	$
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Notes payable	$ 8,150	$
Accounts payable	70,039	
Accrued payrolls and incentives	18,731	
Current portion of long-term debt	437	
Billings in excess of costs	54,565	
Other current liabilities	40,013	
TOTAL CURRENT LIABILITIES	191,935	
COMMITMENTS AND CONTINGENCIES		
LONG-TERM DEBT	57,123	
ACCRUED POSTRETIREMENT BENEFITS & PENSION	17,781	
OTHER LONG-TERM LIABILITIES	8,407	
TOTAL LIABILITIES	275,246	
SHAREHOLDERS' EQUITY		
Common Stock, without par value, 100,000,000 shares authorized; 28,444,281 and 28,067,566 shares issued at October 27, 2001 and January 31, 2001, respectively	52,688	
Currency translation adjustment	(1,163)	
Retained earnings	351,023	
TOTAL SHAREHOLDERS' EQUITY	402,548	
	$ 677,794	$

SEE ACCOMPANYING NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS.

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

	NINE MONTHS ENDED		
	OCTOBER 27, 2001	OCTOBER 28, 2000	OCTOBER
	(UNAUDITED)		
Sales	$ 1,061,572	$ 814,333	$
Cost of sales	914,853	677,185	
Gross profit	146,719	137,148	

Recovery of costs incurred, net	(39,000)	-	
Selling and administrative expenses	112,165	97,818	
Interest expense	5,212	6,739	
Interest and investment income	(2,830)	(6,230)	
Other (income) expense, net	(730)	1,051	
	74,817	99,378	
Earnings before income taxes	71,902	37,770	
Income tax expense	26,246	13,903	
Net earnings from continuing operations	45,656	23,867	
Loss on disposal of discontinued operations, net of tax of $372	(628)	-	
Net earnings	$ 45,028	$ 23,867	$
Weighted average shares outstanding:			
Basic	28,285	28,018	
Diluted	28,951	28,277	
Earnings per share:			
Basic			
Continuing operations	$ 1.61	$ 0.85	$
Loss on disposal of discontinued operations	(0.02)	-	
NET EARNINGS PER SHARE	$ 1.59	$ 0.85	$
Diluted			
Continuing operations	$ 1.58	$ 0.84	$
Loss on disposal of discontinued operations	(0.02)	-	
NET EARNINGS PER SHARE	$ 1.56	$ 0.84	$
Cash dividends per share	$ 0.255	$ 0.255	$

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

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

	NINE MONTHS ENDED	
	OCTOBER 27, 2001	OCTOBER 28, 2000
		(Unau
OPERATING ACTIVITIES		
Net earnings from continuing operations	$ 45,656	$ 23,867

Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Depreciation and amortization	14,867	16,135
Gain on sale of business assets	-	(5,649)
Change in operating assets and liabilities net of the effect of acquisition, divestiture and discontinued operations:		
Accounts and notes receivable, net	(54,985)	86,284
Recoverable costs and accrued profits not yet billed	19,819	(12,756)
Inventories, net	(26,280)	(21,511)
Other current and noncurrent assets	(1,113)	2,720
Accounts payable	3,602	(28,839)
Accrued payrolls and incentive	(2,613)	(5,492)
Billings in excess of costs	23,927	30,444
Other current liabilities	6,895	(8,248)
Accrued postretirement benefits & pension	(1,098)	801
Other long-term liabilities	161	6,364
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	28,838	84,120
INVESTING ACTIVITIES		
Expenditures for property, plant and equipment	(36,112)	(26,255)
Proceeds from sale of business assets	2,323	52,622
Disposal of property, plant and equipment, net	3,165	2,212
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	(30,624)	28,579
FINANCING ACTIVITIES		
Additions to long-term borrowings	-	20,417
Payments on long-term borrowings	(20,536)	(20,522)
Payments on short-term notes payable	(4,461)	(12,172)
Dividends paid	(7,193)	(7,138)
Exercise of stock options	6,753	58
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	(25,437)	(19,357)
Increase (Decrease) in cash and cash equivalents	(27,223)	93,342
Cash and cash equivalents, beginning of period	109,955	11,715
Cash and cash equivalents, end of period	$ 82,732	$ 105,057
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Net cash paid during the period for:		
Interest	$ 4,856	$ 5,171
Income tax	24,260	16,810

SEE ACCOMPANYING NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS.

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

	NINE MONTHS ENDED (Unaudited)		
	OCTOBER 27, 2001	OCTOBER 28, 2000	OCTOBER 27, 2
Net earnings	$ 45,028	$ 23,867	$ 11,68
Currency translation loss	(234)	(299)	(14
Comprehensive income	$ 44,794	$ 23,568	$ 11,53

SEE ACCOMPANYING NOTES TO THE CONSOLIDATED CONDENSED FINANCIAL STATEMENTS.

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 nine months ended October 27, 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):

	NINE MONTHS ENDED		THREE M
	OCTOBER 27, 2001	OCTOBER 28, 2000	OCTOBER 27, 200
		(Unaudited)	
SALES			
Power Products	$ 548,652	$441,386	$163,881
Tactical Vehicle Systems	321,036	203,346	103,771
Petroleum Equipment	109,045	60,606	37,439
Airline Products	64,651	83,409	17,663
Other Business Activities	18,188	25,586	6,908
Total	$1,061,572	$814,333	$329,662
OPERATING PROFIT (LOSS)			
Power Products	$ 9,069	$ 8,820	$ (1,535)
Tactical Vehicle Systems	87,892	38,980	33,186
Petroleum Equipment	2,103	1,224	(1,492)
Airline Products	(14,708)	(4,802)	(7,799)
Other Business Activities	687	2,446	354
Total	85,043	46,668	22,714
OPERATING PROFIT (LOSS) PERCENTAGE			
Power Products	1.7%	2.0%	-0.9%
Tactical Vehicle Systems	27.4	19.2	32.0
Petroleum Equipment	1.9	2.0	(4.0)
Airline Products	(22.7)	(5.8)	(44.2)
Other Business Activities	3.8	9.6	5.1
Total	8.0	5.7	6.9

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

	NINE MONTHS ENDED (Unaudited) OCTOBER 27,2001	OCTOBER 28,2000	OCTO
Operating profit	$ 85,043	$46,668	
Corporate expenses, net	(10,759)	(8,389)	
Non-operating interest and investment income	2,830	6,230	
Interest expense	(5,212)	(6,739)	
Earnings before income taxes	$ 71,902	$37,770	

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 $6 million of unamortized goodwill as of October 27, 2001, and expects to recognize approximately $0.5 million 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.

In August 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which is effective for the Company beginning February 2002. SFAS No. 144 supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets to Be Disposed Of," and the accounting and reporting provisions relating to the disposal of a segment of a business of Accounting Principles Board Opinion No. 30. We do not anticipate that the adoption of SFAS No. 144 will have a material impact on our financial position.

The FASB issued SFAS No. 143, "Accounting For Asset Retirement Obligations," in 2001, covering the accounting for legal obligations associated with retirement of long-lived assets. SFAS No. 143 must be adopted by the Company effective February 1, 2003. The Company does not expect the adoption of SFAS No. 143 to have a material effect on its financial statements.

NOTE D--COMMITMENTS AND CONTINGENCIES

The Company issues bid and performance guarantees in the form of performance bonds or standby letters of credit. Performance type letters of credit totaled $5 million at October 27, 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 foreign operations and 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 October 27, 2001 is $3.5 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--RECONCILIATION OF BASIC TO DILUTED SHARES OUTSTANDING

	NINE MONTHS ENDED		
	OCTOBER 27, 2001	OCTOBER 28, 2000	OCTO
Numerator:			
Income available to common shareholders			
From continuing operations	$45,656	$23,867	
Net earnings	45,028	23,867	
Denominator:			
Denominator for basic earnings per share -			
Weighted-average shares	28,285	28,018	
Effect of dilutive securities:			
Employee and director stock options	666	259	
Denominator for diluted earnings per share -			
Adjusted weighted-average shares	28,951	28,277	
Basic earnings per share			
From continuing operations	$ 1.61	$ 0.85	
Net earnings	1.59	0.85	
Diluted earnings per share			
From continuing operations	1.58	0.84	
Net earnings	1.56	0.84	
Number of anti-dilutive stock options outstanding	256	865	

NOTE F--SIGNIFICANT ITEMS

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

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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, net of associated costs and related receivable in its third fiscal quarter. 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.

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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 third quarter 2001" commenced on July 29, 2001 and ends on October 27, 2001.

RESULTS OF OPERATIONS

Sales for Fiscal third quarter 2001 grew 15.2% to $329.7 million compared to sales of $286.2 million in the same period a year ago. Gross profit percentage for the same period was 12.2%, lower than the 14.8% recorded during Fiscal second quarter 2001 and the 17.4% recorded in last year's third quarter.

Sales for the first nine months of Fiscal 2001 grew 30.4% to $1,061.6 million versus $814.3 million for the first nine months of Fiscal 2000. Gross profit percentage for the same period was 13.8%, lower than the 16.8% recorded for the first nine months of Fiscal 2000. This year's first nine months includes nonrecurring items that impacted cost of goods sold by $5.1 million and which impacted gross profit by 0.5 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 segment resulting from the events of September 11, higher than anticipated costs for certain contracts in the Petroleum segment, lower margins in the Tactical Vehicle Systems segment due to sales mix, and costing and inventory valuation issues that resulted in lower margins in the Power Products segment.

Recovery of costs incurred, net represents a settlement of $18.5 million reached on August 15, 2001 with the U.S. Government, through the Alternative Disputes Resolution process, pertaining to changes in drive train components on vehicles produced and delivered on the first contract. Payment of the settlement is expected by December 31 of this year. However, in the event funds are not available, the settlement also provides for interest at the contract disputes act rate from January 1, 2002 until payment is made.

Selling and administrative expenses were $40.2 million, or 12.2% of sales for Fiscal third quarter 2001 compared to $34.0 million or 11.9% of sales in Fiscal third quarter 2000. Selling and administrative expenses for the first nine months of Fiscal 2001 were $112.2 million, or 10.6% of sales compared to $97.8 million, or 12.0% for the same period in the prior year. The first nine months of Fiscal 2001 included $1.5 million pertaining to legal expenses and provisions for a doubtful receivable, $2.3 million pertaining to a systems automation project, $1.1 million for relocation of power generation manufacturing operations, $4.6 million associated with restructuring and other one time costs. The first nine months of Fiscal 2000 included a $7.0 million provision for a doubtful receivable.

Interest and investment income of $0.7 million for the Fiscal third quarter 2001 was lower versus the $1.6 million recorded for Fiscal third quarter 2000 due to lower average cash and investment balances, compounded by lower effective interest rates. Interest and investment income decreased $3.4 million during the first nine months of Fiscal 2001 to $2.8 million compared to $6.2 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 $1.5 million principally due to lower average borrowings.

Net earnings in Fiscal third quarter 2001 were $11.7 million or $0.40 per diluted share versus $8.6 million or $0.30 per diluted share in last year's third quarter. Net earnings from continuing operations for the first nine months increased by 91.2% to $45.7 million or $1.58 per share compared to $23.9 million or $0.84 per diluted share in the same period for Fiscal 2000. Net loss from discontinued operations in the first nine months of Fiscal 2001 was $0.6 million or $0.02 per share. Total net earnings for the first nine months of Fiscal 2001 were $45.0 million or $1.56 per diluted share compared with $23.9 million or $0.84 per diluted 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.

The Power Products segment, which is responsible for marketing and aftermarket support of a wide range of industrial equipment, recorded Fiscal third quarter sales of $163.9 million, as compared to sales of $158.7 million in the same period of Fiscal 2000. The segment reported an operating loss of $1.5 million in the fiscal third quarter versus a $6.1 million operating profit in the comparable period of last year. The $7.6 million unfavorable variance included $3.4 million in nonrecurring expenses associated with a systems automation project and relocation of power generation manufacturing operations and a $2.6 million charge related to costing and inventory valuation issues. Parts sales in the Fiscal third quarter were down slightly from the second quarter and last year while service sales in the Fiscal third quarter were up over the second quarter and last year. Results in the Power Generation portion of this segment were below expectations due to higher than anticipated costs on sales levels below those required to break even. However, the low market share position in this segment provides a new management team the opportunity for growth.

The Tactical Vehicle Systems segment, which manufactures tactical vehicles for the U.S. Army and others, recorded sales of $103.8 million in the Fiscal third quarter compared to $69.0 million a year ago. Operating profit for the quarter totaled $33.2 million, compared with $10.0 million in the Fiscal third quarter of 2000. Fiscal 2001 third quarter results included an $18.2 million settlement with the U.S. Army, net of $0.3 million in expenses related to the settlement process. Payment of the settlement is anticipated during the Fiscal fourth quarter of 2001. Shipments for the third quarter were 551 trucks and 198 trailers compared to 546 trucks and 210 trailers in the second quarter. Sales for trucks in the fourth quarter are anticipated to be up while trailer shipments are expected to be down. Overall sales in TVS are expected to remain relatively flat in the fourth quarter while margin rates should return to those experienced in the second quarter of 2001.

The Petroleum Equipment segment manufactures equipment for the oil and gas exploration, production, and well stimulation industries. Sales in this segment totaled $37.4 million for the Fiscal third quarter, 42 percent higher than the $26.3 million reported in the same period last year. Operating results were adversely impacted by higher than forecasted costs for certain contracts completed during the quarter and higher system costs in the current quarter compared with a year ago. As a result, the operating loss for the Fiscal third quarter was $1.5 million versus a $1.5 million operating profit for the same period of the previous year. The order backlog at the end of the Fiscal third quarter 2001 totaled $44.3 million, compared with $63.0 million at the end of the second Fiscal quarter. Volume is anticipated to be down with margin rates improving from the third quarter, as costs are brought into line by a new leadership team driving change and more profitable contracts convert to sales.

The Airline Products segment, which manufactures airline ground support products and mobile railcar movers, recorded sales of $17.7 million in the Fiscal third quarter, compared with $26.8 million in the same quarter last year. Sales were adversely impacted by the events of September 11, which resulted in cancellations of existing orders and delays in receiving new orders from the commercial airlines. Operating loss for the fiscal third quarter was $7.8 million versus a $0.5 million loss in the previous year. Included in the results for the current quarter were $4.0 million in non-recurring expenses related to restructuring and rationalization of facilities in Denver, Colorado; Houston, Texas; and the Atlanta, Georgia area. This segment is anticipating one more quarter of manufacturing and organizational transition as it prepares to achieve a breakeven run rate with a significantly reduced volume. There has been more than a 35% reduction in staffing during the year and other costs are under review. The focus continues to be on introducing new electric products and regional airline products as well as looking at the military and material handling markets for additional opportunity.

Other business activities not identified in a specific segment include predominantly gas compression equipment sales. Fiscal third quarter sales were $6.9 million, versus $5.4 million for the comparable period last year. Third quarter operating profit was $0.4 million compared to a $0.1 million operating profit in last year's third quarter.

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 October 27, 2001 and as of October 28, 2000 were as follows:

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	October 27, 2001	October 28, 2000
	(In millions)	
Tactical Vehicle Systems	$ 404.7	$ 742.8
Power Products	133.6	119.2
Petroleum Equipment	44.3	65.6
Airline Products	8.4	19.5
All Other	5.3	16.5
	$ 596.3	$ 963.6

Total unfilled orders decreased $133.6 million during the quarter. The TVS backlog continued to decline since the Company does not report the contract modification that adds option year agreements in its backlog. Such option year additions are added to the backlog as Congressional funding is in place. Backlog for the portion of the Company's business excluding TVS declined $45.2 million, including an $18.7 million reduction in Petroleum Equipment segment and $12.5 million in Power Products segment. These decreases resulted from the downward pressure in pricing in the oil and gas sector of the economy, as well as the recent slowdown of the general economy. In the oil & gas markets, short cycle orders are down in both Petroleum and Power Products as demand has been impacted by lower energy prices. In the near term, the market opportunity for orders could be down as much as 10%. The backlog in the Airline Products segment declined more than 50%, as certain customers reassessed their capital requirements in the wake of significant recent current events.

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 third quarter 2001, cash of $7.9 million was consumed by operations. This decrease resulted from higher receivables associated with the timing of collections on certain major projects. During the same period, the Company invested $13.7 million in property, plant and equipment for the purchase and implementation of its new enterprise information system, the construction of a new service facility in Dallas, Texas, and other projects. Payments of cash dividends on common stock totaled $2.4 million during the quarter and cash and equivalents were $82.7 million at October 27, 2001, a decrease of $25.0 million versus the prior quarter. Borrowings at the end of the Fiscal third quarter were $65.7 million, a decrease of $33.9 million versus the beginning of the Fiscal year. The decrease in debt was principally due to a scheduled repayment of $20.0 million and $8.9 million mortgage noncash 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. At October 27, 2001 the Company had no borrowings outstanding under an unsecured revolving debt facility that could provide up to approximately $144 million, net of $6 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.

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 6. EXHIBITS AND REPORTS ON FORM 8-K.

Form 8-K Report Date - August 23, 2001 (Second Quarter Fiscal 2001 Financial Results)
Items reported - Item 5. Other Events
Item 7. Exhibits

Form 8-K Report Date - August 28, 2001 (Presentation to Investors)
Items reported - Item 7. Exhibits
Item 9. Regulation FD Disclosure

Form 8-K Report Date - September 18, 2001 (Announces Third Quarter Dividend)
Items reported - Item 5. Other Events
Item 7. Exhibits

Form 8-K Report Date - October 23, 2001 (Fiscal Third Quarter Outlook)
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 10th day of December 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)

EXHIBIT INDEX

EXHIBIT NUMBER AND DESCRIPTION

None