

DRS TECHNOLOGIES INC
Form 10-Q
February 14, 2003

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended December 31, 2002

o **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 1-8533**

DRS Technologies, Inc.

Delaware
(State or other jurisdiction of
incorporation or organization)

**5 Sylvan Way, Parsippany, New Jersey 07054
(973) 898-1500**

13-2632319
(IRS Employer
Identification No.)

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 and 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 ý

No o

As of February 10, 2003, 22,421,236 shares of DRS Technologies, Inc. Common Stock, \$.01 par value, were outstanding.

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

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For the Quarter Ended December 31, 2002**

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

**DRS TECHNOLOGIES, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(in thousands, except share data)**

| | December 31, 2002 | March 31, 2002 |
|--|----------------------|-------------------|
| | (Unaudited) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 147,779 | \$ 117,782 |
| Accounts receivable, net | 139,037 | 110,861 |
| Inventories, net of progress payments | 130,636 | 120,910 |
| Prepaid expenses and other current assets | 18,049 | 9,276 |
| Total current assets | 435,501 | 358,829 |
| Property, plant and equipment, less accumulated depreciation and amortization of \$49,579 and \$45,389 at December 31, 2002 and March 31, 2002, respectively | 77,929 | 50,481 |
| Acquired intangible assets, less accumulated amortization of \$8,868 and \$7,028 at December 31, 2002 and March 31, 2002, respectively | 39,187 | 34,133 |
| Goodwill | 365,648 | 142,610 |
| Deferred income taxes and other noncurrent assets | 21,529 | 15,038 |
| Total assets | \$ 939,794 | \$ 601,091 |

| | December 31, 2002 | March 31, 2002 |
|--|----------------------|-------------------|
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Current installments of long-term debt | \$ 7,625 | \$ 1,435 |
| Short-term bank debt | 1,039 | 226 |
| Accounts payable | 56,024 | 49,671 |
| Accrued expenses and other current liabilities | 217,053 | 142,260 |
| Total current liabilities | 281,741 | 193,592 |
| Long-term debt, excluding current installments | 217,345 | 138,060 |
| Other noncurrent liabilities | 14,405 | 12,204 |
| Total liabilities | 513,491 | 343,856 |
| Stockholders' equity: | | |
| Preferred stock, \$10.00 par value per share. Authorized 2,000,000 shares; none issued at December 31, 2002 and March 31, 2002 | | |
| Common Stock, \$.01 par value per share. Authorized 30,000,000 shares; issued and outstanding 22,358,361 and 16,834,052 shares at December 31, 2002 and March 31, 2002, respectively | | |
| | 224 | 168 |
| Additional paid-in capital | 342,853 | 197,387 |
| Retained earnings | 84,859 | 64,356 |
| Accumulated other comprehensive losses | (1,633) | (4,630) |
| Unamortized stock compensation | | (46) |
| Total stockholders' equity | 426,303 | 257,235 |
| Commitments and contingencies | | |
| Total liabilities and stockholders' equity | \$ 939,794 | \$ 601,091 |

See accompanying Notes to Consolidated Financial Statements.

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES
Consolidated Statements of Earnings
(in thousands, except per-share data)
(Unaudited)

| | Three Months Ended December 31, | | Nine Months Ended December 31, | |
|-------------------------------|------------------------------------|---------------|-----------------------------------|---------------|
| | 2002 | 2001 | 2002 | 2001 |
| Revenues | \$ 167,540 | \$ 141,238 | \$ 459,974 | \$ 360,768 |
| Costs and expenses | 150,970 | 127,360 | 414,008 | 326,503 |
| Operating income | 16,570 | 13,878 | 45,966 | 34,265 |
| Interest income | 158 | 20 | 841 | 64 |
| Interest and related expenses | 2,653 | 3,252 | 7,408 | 7,215 |
| Other (income) expense, net | (14) | 99 | 376 | 128 |

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| | Three Months Ended December 31, | | Nine Months Ended December 31, | |
|--|------------------------------------|-----------------|-----------------------------------|------------------|
| | | | | |
| Earnings before minority interest and income taxes | 14,089 | 10,547 | 39,023 | 26,986 |
| Minority interest | 373 | 414 | 1,053 | 1,040 |
| Earnings before income taxes | 13,716 | 10,133 | 37,970 | 25,946 |
| Income taxes | 6,310 | 4,762 | 17,467 | 12,194 |
| Net earnings | \$ 7,406 | \$ 5,371 | \$ 20,503 | \$ 13,752 |
| Net earnings per share of common stock: | | | | |
| Basic earnings per share | \$ 0.42 | \$ 0.42 | \$ 1.20 | \$ 1.11 |
| Diluted earnings per share | \$ 0.41 | \$ 0.38 | \$ 1.15 | \$ 1.02 |

See accompanying Notes to Consolidated Financial Statements.

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DRS TECHNOLOGIES, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(in thousands)
(Unaudited)

| | Nine Months Ended December 31, | |
|--|-----------------------------------|-----------------|
| | 2002 | 2001 |
| Cash flows from operating activities: | | |
| Net earnings | \$ 20,503 | \$ 13,752 |
| Adjustments to reconcile net earnings to cash flows from operating activities: | | |
| Depreciation and amortization | 12,012 | 9,596 |
| Loss on sale of business | 575 | |
| Other, net | 1,749 | (1,121) |
| Changes in assets and liabilities, net of effects from business combinations and dispositions: | | |
| (Increase) decrease in accounts receivable | (7,743) | 11,839 |
| Increase in inventories | (4,055) | (20,207) |
| Increase in prepaid expenses and other current assets | (6,227) | (6,040) |
| Increase in accounts payable | 4,510 | 3,238 |
| (Decrease) increase in accrued expenses and other current liabilities | (3,228) | 4,735 |
| Increase (decrease) in customer advances | 6,607 | (2,482) |
| Other, net | 686 | 106 |
| Net cash provided by operating activities | 25,389 | 13,416 |
| Cash flows from investing activities: | | |
| Capital expenditures | (13,196) | (10,487) |
| Payments pursuant to business combinations | (196,412) | (72,950) |
| Proceeds from sales of businesses | 7,684 | |
| Other, net | 213 | 156 |
| Net cash used in investing activities | (201,711) | (83,281) |

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| | Nine Months Ended December 31, | |
|--|-----------------------------------|-------------------|
| | <hr/> | |
| Cash flows from financing activities: | | |
| Net borrowings (payments) of short-term debt | 755 | (81) |
| Additional borrowings of long-term debt | 81,500 | 218,250 |
| Debt issuance costs | (2,254) | (4,664) |
| Repayment of borrowings of long-term debt | (7,774) | (160,736) |
| Retirement of long-term debt | (12,195) | |
| Proceeds from issuance of common stock | 145,303 | 113,462 |
| Proceeds from stock option exercises | 581 | 4,801 |
| Other, net | (136) | |
| | <hr/> | <hr/> |
| Net cash provided by financing activities | 205,780 | 171,032 |
| | <hr/> | <hr/> |
| Effect of exchange rates on cash and cash equivalents | 539 | 621 |
| | <hr/> | <hr/> |
| Net increase in cash and cash equivalents | 29,997 | 101,788 |
| Cash and cash equivalents, beginning of period | 117,782 | 2,324 |
| | <hr/> | <hr/> |
| Cash and cash equivalents, end of period | \$ 147,779 | \$ 104,112 |
| | <hr/> | <hr/> |

See accompanying Notes to Consolidated Financial Statements.

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DRS TECHNOLOGIES, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements

(Unaudited)

1. Basis of Presentation

The accompanying unaudited Consolidated Financial Statements of DRS Technologies, Inc. and Subsidiaries (DRS or the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America and with the instructions to Form 10-Q and Article 10 of Regulation S-X. The Company has continued to follow the accounting policies set forth in the consolidated financial statements included in its fiscal 2002 Annual Report on Form 10-K filed with the Securities and Exchange Commission. In the opinion of the Company, the interim financial information provided herein reflects all adjustments (consisting of normal and recurring adjustments) necessary for a fair presentation of the Company's consolidated financial position as of December 31, 2002, the results of operations for the three- and nine-month periods ended December 31, 2002 and 2001, and cash flows for the nine-month periods ended December 31, 2002 and 2001. The results of operations for the three- and nine-months ended December 31, 2002 are not necessarily indicative of the results to be expected for the full year.

For further information, these interim consolidated financial statements should be read in conjunction with the Consolidated Financial Statements of the Company for the fiscal year ended March 31, 2002, included in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2002.

2. Issuance of Common Stock

On December 23, 2002, the Company issued 5,462,500 shares of its common stock in a public offering for \$28.00 per share, including shares related to an over-allotment option that was granted to the underwriters. Upon closing, the Company received net proceeds of \$145.3 million. Approximately \$12.0 million of the net proceeds were used during the third quarter of fiscal 2003 to repay certain debt balances acquired in connection with the Company's November 27, 2002 acquisition of Paravant Inc. (see footnote 3 below). The balance of the offering proceeds will be used for general corporate purposes, including acquisitions, capital expenditures and working capital requirements.

3. Business Combinations and Disposals

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On January 15, 2003, the Company acquired the assets and certain liabilities of the Electromagnetics Development Center of Kaman Aerospace, a subsidiary of Kaman Corporation, located in Hudson, Massachusetts, for \$27.5 million in cash, subject to adjustment, plus \$7.5 million of contingent consideration. Contingent consideration is based on a funded booking milestone, as defined in the purchase agreement. If the funded booking milestone is not fulfilled on or before December 31, 2008, DRS will have no liability or obligation to pay any contingent consideration. The earn-out period began on the closing date of the acquisition. Kaman's Electromagnetics Development Center is a leader in the development of high-performance, lightweight electric motors, generators and drive electronics for defense, industrial and transportation applications. Renamed DRS Electric Power Technologies, Inc., the company operates as part of DRS's Electronic Systems Group (ESG). The addition of DRS Electric Power Technologies, Inc. is complementary to DRS's existing position in ship electric propulsion equipment, control equipment, high-performance networks, tactical displays and specialty reactor plant instrumentation.

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On November 27, 2002, a wholly-owned subsidiary of the Company merged with and into Paravant Inc. (Paravant), with Paravant being the surviving corporation and continuing as a wholly-owned subsidiary of DRS. Consideration in the Paravant acquisition was approximately \$92.9 million in cash and the assumption of \$15.9 million in debt. In addition to the purchase price, the estimated costs related to the acquisition, including professional fees, approximated \$4.0 million. The Company financed the acquisition with borrowings under its credit facility (see footnote 4 for a description of the credit facility). Paravant is a designer and manufacturer of highly engineered, technically advanced, defense electronics for U.S. and allied international military and intelligence agency applications. Headquartered in Morristown, New Jersey, the company manufactures rugged computer systems and communications interfaces serving military Command, Control, Communications, Computer, Intelligence and Surveillance (C4ISR) initiatives. Paravant also produces high-speed processing equipment for the intelligence community and offers modernization design and installation services for select rotary- and fixed-wing military aircraft. The Paravant acquisition is highly compatible with the Company's goals of expanding its core tactical systems business base and increasing its presence in the U.S. Air Force and high-end signal intelligence programs supporting government agencies.

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed in the Paravant acquisition. The Company is in process of obtaining third-party valuations of certain assets acquired, as well as performing its own internal assessment of the acquired contracts; thus, the preliminary allocation of the purchase price will change. The Company expects to complete the purchase price allocation in the fourth quarter of fiscal 2003.

| | November 27, 2002 |
|--|------------------------------|
| | (in thousands) |
| Accounts receivable | \$ 9,555 |
| Inventory | 12,318 |
| Other current assets | 1,286 |
| Property, plant and equipment | 9,083 |
| Other assets | 1,380 |
| Goodwill | 91,377 |
| | 124,999 |
| Accrual for future costs on acquired contracts | 4,324 |
| Other current liabilities | 7,361 |
| Long-term debt | 15,944 |
| Other liabilities | 445 |
| | 28,074 |
| Net assets acquired | \$ 96,925 |

The \$91.4 million of goodwill was allocated to the Company's ESG operating segment.

The following unaudited pro forma financial information shows the results of operations for the three months ended December 31, 2002 and 2001, and the nine-month periods ended December 31, 2002 and 2001, as though the acquisition of Paravant had occurred on April 1, 2001. The unaudited pro forma presentation reflects adjustments for: (i) the capitalization of general and administrative costs, to be consistent with

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DRS's accounting practice, (ii) the amortization of \$5.0 million of estimated acquired intangible assets over 10 years, (iii) interest expense on borrowings associated with the Paravant

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acquisition, (iv) the elimination of goodwill amortization in certain periods presented to be consistent with DRS's April 1, 2001 adoption of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets (SFAS 142)", and (v) the income tax effect on the pro forma adjustments and Paravant's pre-tax earnings using a statutory tax rate of 42%. The pro forma adjustments related to the Paravant acquisition are based on a preliminary purchase price allocation. Differences between the preliminary and final purchase price allocation could have a material impact on the unaudited pro forma financial information presented. The unaudited pro forma financial information below is presented for illustrative purposes only and is not necessarily indicative of the operating results that would have been achieved had the acquisition been completed as of the date indicated above or the results that may be obtained in the future.

| | Three Months Ended December 31, | | Nine Months Ended December 31, | |
|------------------------------------|---------------------------------------|------------|-----------------------------------|------------|
| | 2002 | 2001 | 2002 | 2001 |
| | (in thousands, except per share data) | | | |
| Revenues | \$ 182,229 | \$ 156,942 | \$ 506,880 | \$ 399,987 |
| Net earnings | \$ 8,360 | \$ 7,313 | \$ 21,887 | \$ 14,552 |
| Earnings per share of common stock | | | | |
| Basic earnings per share | \$ 0.48 | \$ 0.57 | \$ 1.28 | \$ 1.18 |
| Diluted earnings per share | \$ 0.46 | \$ 0.52 | \$ 1.23 | \$ 1.08 |

On November 22, 2002, the Company sold its DRS Advanced Programs, Inc. operating unit (DRS API) for \$7.6 million in cash and recorded a \$0.6 million loss on the sale. DRS API, located in Columbia, Maryland, and operated as part of the Company's ESG operating segment develops, designs, manufactures and markets custom-packaged computers and peripherals, primarily for the Department of Defense and the government intelligence community. The Company wrote off \$2.3 million of goodwill in connection with the sale. The results of operations of DRS API, prior to the sale, are summarized as follows:

| | Three Months Ended December 31, | | Nine Months Ended December 31, | |
|----------------|------------------------------------|----------|-----------------------------------|-----------|
| | 2002 | 2001 | 2002 | 2001 |
| | (in thousands) | | | |
| Revenues | \$ 1,814 | \$ 2,806 | \$ 8,507 | \$ 10,731 |
| Operating loss | \$ (348) | \$ (421) | \$ (1,064) | \$ (192) |

On October 15, 2002, the Company acquired DKD, Inc. (which operated under the name Nytech) for \$13.0 million plus contingent consideration. The \$13.0 million consists of a \$5.0 million cash payment and an \$8.0 million promissory note, bearing interest at a rate of 6%, with payments of \$5.0 million and \$3.0 million due on the first and second anniversaries of the closing, respectively. In addition to the purchase price, the estimated costs related to the acquisition, including professional fees, approximated \$0.5 million. Contingent consideration is based on an aggregate bookings earn-out, as defined in the purchase agreement, and is not to exceed \$17.0 million in the aggregate. The earn-out period began on the closing date of the acquisition and ends on March 31, 2009. Renamed DRS Nytech Imaging Systems, Inc. and located in Irvine, California, the company manufactures and markets uncooled thermal imaging systems for portable weapons, head gear, hand-held devices and vehicle-mounted sights. The business also specializes in the design of stabilized, lightweight gimbals capable of controlling numerous sensors and suitable for mounting on a variety of land, sea and air platforms. The Nytech acquisition enhances DRS's position as a supplier of lightweight thermal imaging systems and

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supports the Company's objectives to further expand its position in the uncooled infrared technology market. The Company is in the process of obtaining third-party valuations of the assets acquired and liabilities assumed, as well as performing its own internal assessment of the acquired contracts; thus, the preliminary allocation of the purchase price may change. Based on preliminary purchase price allocations, the Company has estimated goodwill to be \$13.1 million and has allocated the estimated goodwill to the Electro-Optical Systems Group. The Company expects to complete the purchase price allocation in the first quarter of fiscal 2004.

Pursuant to a purchase agreement effective July 1, 2002, the Company acquired the assets and assumed certain liabilities of the Navy Controls Division (NCD) of Eaton Corporation for \$92.2 million in cash, subject to adjustment. In addition to the purchase price, the estimated costs related to the acquisition, including professional fees, approximated \$3.5 million. The Company financed the acquisition with existing cash on hand. Renamed DRS Power & Control Technologies, Inc. (DRS PCT) and located in Milwaukee, Wisconsin, and Danbury, Connecticut, the company is a leading supplier of high-performance power conversion and instrumentation and control systems for the U.S. Navy's combatant fleet, including nuclear-powered and conventionally powered ships, as well as for specialized industrial customers. Products include ship electric propulsion equipment, power electronics equipment, high-performance networks, shipboard control equipment and control panels, tactical displays, and specialty reactor instrumentation and control equipment. The addition of this unit complements the Company's presence in naval advanced command and control computer display and other ship systems. DRS PCT is being managed as a part of the Company's ESG operating segment.

The following table summarizes the purchase price allocation of the NCD acquisition. With the exception of establishing the acquired pension asset, the NCD purchase price allocation is final. The Company is in the process of obtaining a third party pension valuation, accordingly the purchase price allocation is subject to change in the fourth quarter of fiscal 2003.

| | July 1, 2002 |
|--|-----------------------|
| | (in thousands) |
| Accounts receivable | \$ 13,905 |
| Inventory | 7,737 |
| Property, plant and equipment | 12,470 |
| Goodwill | 96,050 |
| Acquired intangible assets | 6,590 |
| | <hr/> |
| Total assets acquired | 136,752 |
| | <hr/> |
| Accrual for future costs on acquired contracts | 29,948 |
| Accrued warranty | 7,994 |
| Other current liabilities | 3,110 |
| | <hr/> |
| Total liabilities assumed | 41,052 |
| | <hr/> |
| Net assets acquired | \$ 95,700 |
| | <hr/> |

The \$96.1 million of goodwill was allocated to the Company's ESG operating segment. The \$6.6 million in acquired intangible assets were assigned to customer-related intangibles and are being amortized over a period of 20 years.

The following unaudited pro forma financial information shows the results of operations for the three months ended December 31, 2001, and the nine-month periods ended December 31, 2002 and

2001, as though the acquisition of DRS PCT had occurred on April 1, 2001. DRS PCT is included in the Company's operating results for the full three-month period ended December 31, 2002 as the acquisition was completed in July 2002. The unaudited pro forma presentation reflects adjustments for: (i) the capitalization of general and administrative costs, to be consistent with DRS's accounting practice, (ii) the amortization of \$6.6 million of acquired intangible assets over 20 years, (iii) the elimination of goodwill amortization in certain periods presented to be consistent with DRS's April 1, 2001 adoption of SFAS 142, and (iv) the income tax effect on the pro forma adjustments and DRS PCT's pre-tax earnings using a statutory tax rate of 42%. The pro forma adjustments related to the DRS PCT acquisition are based on a preliminary purchase price allocation. Differences between the preliminary and final purchase price allocations could have a significant impact on the unaudited pro

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forma financial information presented. The unaudited pro forma financial information below is presented for illustrative purposes only and is not necessarily indicative of the operating results that would have been achieved had the acquisition been completed as of the date indicated above or the results that may be obtained in the future.

| | Three Months Ended December 31, | Nine Months Ended December 31, | |
|---------------------------------------|------------------------------------|-----------------------------------|------------|
| | 2001 | 2002 | 2001 |
| (in thousands, except per share data) | | | |
| Revenues | \$ 186,925 | \$ 481,557 | \$ 453,045 |
| Net earnings | \$ 7,843 | \$ 20,739 | \$ 16,976 |
| Earnings per share of common stock | | | |
| Basic earnings per share | \$ 0.61 | \$ 1.21 | \$ 1.37 |
| Diluted earnings per share | \$ 0.55 | \$ 1.16 | \$ 1.26 |

On May 27, 2002, the Company sold the assets of its DRS Ahead Technology operating unit. The operating unit produced magnetic head components used in the manufacturing process of computer disk drives and manufactured magnetic video recording heads used in broadcast television equipment. DRS Ahead Technology recorded \$1.3 million of revenues and \$0.4 million of operating loss for the period it was owned by the Company during the first quarter of fiscal 2003. The operating unit recorded \$2.4 million of revenues and \$0.1 million of operating loss for the third quarter of fiscal 2002, and \$6.8 million and \$0.6 million of revenues and operating loss, respectively, during the nine-month period ended December 31, 2001. The assets of DRS Ahead Technology were sold for their aggregate book value, and DRS received an interest bearing promissory note in the amount of \$3.1 million as consideration for the sale. The promissory note bears interest and is payable over an 80-month term. No gain or loss was recorded on the sale.

On April 11, 2002, the Company acquired the assets of the U.S.-based Unmanned Aerial Vehicle (UAV) business of Meggitt Defense Systems Texas, Inc., a unit of Meggitt PLC, for \$0.8 million in cash. In addition to the purchase price, the costs related to the acquisition were approximately \$0.2 million. The business, located in Mineral Wells, Texas, and now operating as DRS Unmanned Technologies, Inc., provides close-range, low-weight, low-noise, medium-duration UAVs supporting military special operations missions. Applications for these products include tactical short-range surveillance, radio relay, and command, control, communications, computers, intelligence, surveillance and reconnaissance. The preliminary estimate of the excess of costs over the net amounts allocated to the assets acquired and liabilities assumed in the acquisition (goodwill) and the appraised value of an identifiable intangible asset were approximately \$0.3 million and \$0.3 million, respectively. The goodwill has been allocated to the Company's "Other" operating segment. The Company is in the process of finalizing its internal assessment of the acquired contracts; thus the preliminary allocation of the purchase price will likely change. The Company will complete the purchase price allocation in the fourth quarter of fiscal 2003.

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During fiscal 2003, the Company finalized the purchase price allocation associated with its fiscal 2002 second quarter acquisition of the Sensors and Electronic Systems business of The Boeing Company (SES acquisition). The following table summarizes the allocation of the assets acquired and liabilities assumed in the SES acquisition. As compared with the preliminary purchase price allocation disclosed in the Company's March 31, 2002 Form 10-K, the final purchase price allocation reflects a net increase to goodwill of \$22.3 million and a corresponding net adjustment to inventory, accrual for future costs on acquired contracts and property, plant and equipment. These adjustments reflect the Company's final valuation of the acquired business.

| | September 28, 2001 |
|-------------------------------|-----------------------|
| | (in thousands) |
| Accounts receivable | \$ 8,348 |
| Inventory | 7,267 |
| Property, plant and equipment | 7,666 |
| Goodwill | 86,759 |
| Acquired intangible assets | 14,000 |
| Total assets acquired | 124,040 |

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| | September 28, 2001 |
|--|-----------------------|
| Accrual for future costs on acquired contracts | 58,579 |
| Other current liabilities | 5,323 |
| Total liabilities assumed | 63,902 |
| Net assets acquired | \$ 60,138 |

All of the Company's acquisitions have been accounted for as purchase business combinations and are included in the Company's results of operations from their respective acquisition dates. The Company values contracts acquired in connection with a business combination at remaining contract value less DRS's estimated costs to complete and a profit margin commensurate with the profit margin the Company earns on similar contracts.

4. Inventories

Inventories are summarized as follows:

| | December 31, 2002 | March 31, 2002 |
|---------------------------------|----------------------|-------------------|
| Work-in-process | \$ 169,490 | \$ 139,748 |
| Raw material and finished goods | 8,114 | 9,127 |
| | 177,604 | 148,875 |
| Less progress payments | (46,968) | (27,965) |
| Total | \$ 130,636 | \$ 120,910 |

General and administrative costs included in work-in-process were \$20.6 million and \$16.3 million at December 31, 2002 and March 31, 2002, respectively. General and administrative expenses included in costs and expenses amounted to \$28.2 million and \$28.5 million for the three-month periods ended December 31, 2002 and 2001, respectively, and \$82.9 million and \$70.7 million, respectively, for the nine-month periods then ended. Included in those amounts are expenditures for internal research and development amounting to \$3.5 million and \$2.5 million for the fiscal quarters ended December 31, 2002 and 2001, respectively, and \$10.0 million and \$7.1 million, respectively, for the nine-month periods then ended.

5. Goodwill and Intangible Assets

The following disclosure presents certain information about the Company's acquired intangible assets as of December 31, 2002 and March 31, 2002. All acquired intangible assets are being amortized over their estimated useful lives, as indicated below, with no estimated residual values.

| Acquired Intangible Assets | Weighted Average Amortization Period | Gross Carrying Amount | Accumulated Amortization | Net Balance |
|---------------------------------------|---|--------------------------|-----------------------------|----------------|
| (in thousands) | | | | |
| As of December 31, 2002 | | | | |
| Amortized acquired intangible assets: | | | | |
| Technology-based intangibles | 21 years | \$ 22,955 | \$ (6,050) | \$ 16,905 |
| Customer-related intangibles | 19 years | 25,100 | (2,818) | 22,282 |

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| Acquired Intangible Assets | Weighted Average Amortization Period | Gross Carrying Amount | Accumulated Amortization | Net Balance |
|---------------------------------------|--------------------------------------|-----------------------|--------------------------|-------------|
| Total | | \$ 48,055 | \$ (8,868) | \$ 39,187 |
| As of March 31, 2002 | | | | |
| Amortized acquired intangible assets: | | | | |
| Technology-based intangibles | 21 years | \$ 22,931 | \$ (5,155) | \$ 17,776 |
| Customer-related intangibles | 19 years | 18,230 | (1,873) | 16,357 |
| Total | | \$ 41,161 | \$ (7,028) | \$ 34,133 |

The aggregate acquired intangible asset amortization expense for each of the three-month periods ended December 31, 2002 and 2001 was \$0.5 million, and for the nine-month periods ended December 31, 2002 and 2001 was \$1.9 million and \$1.2 million, respectively. The estimated acquired intangible amortization expense for the fiscal year ending March 31, 2003 is \$2.6 million and the estimated acquired intangible amortization expense for each of the subsequent four fiscal years ending March 31, 2007 is approximately \$2.7 million.

The table below reconciles the change in the carrying amount of goodwill by operating segment for the period from March 31, 2002 to December 31, 2002. As discussed in Note 2, the Company recorded a \$22.3 million net increase to the Electro-Optical Systems Group's goodwill during fiscal 2003. The increase is the result of the Company's finalization of its internal assessment of certain contracts acquired in connection with the SES acquisition, as well as an adjustment to acquired property, plant and equipment. The Company also recorded a \$1.2 million adjustment to the Electronic Systems Group's goodwill, which was related to the finalization of its purchase price allocation on the fiscal 2002 acquisition of the Electro Mechanical Systems unit of Lockheed Martin. The Company's DRS API operating unit was sold in the third quarter of fiscal 2003, accordingly, the Electronic Systems Group's goodwill was reduced by \$2.3 million.

| | Electronic Systems Group | Electro-Optical Systems Group | Flight Safety and Communications Group | Other | Total |
|---|--------------------------|-------------------------------|--|--------|------------|
| (in thousands) | | | | | |
| Balance as of March 31, 2002 | \$ 28,127 | \$ 84,410 | \$ 30,073 | \$ | \$ 142,610 |
| Fiscal 2003 acquisitions | 187,427 | 13,112 | | 265 | 200,804 |
| Purchase price allocation adjustments on fiscal 2002 acquisitions | 1,236 | 22,270 | | | 23,506 |
| Foreign currency translation adjustment | 896 | | 155 | | 1,051 |
| Sale of business unit | (2,323) | | | | (2,323) |
| Balance as of December 31, 2002 | \$ 215,363 | \$ 119,792 | \$ 30,228 | \$ 265 | \$ 365,648 |

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6. Debt

A summary of debt is as follows:

| | December 31, 2002 | March 31, 2002 |
|---------------------------|-------------------|----------------|
| (in thousands) | | |
| Term notes | \$ 213,063 | \$ 139,300 |
| Revolving lines of credit | | |
| Other obligations | 12,946 | 421 |

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| | December 31, 2002 | March 31, 2002 |
|--|-----------------------------|-----------------------------|
| | <u> </u> | <u> </u> |
| | 226,009 | 139,721 |
| Less: | | |
| Current installments of long-term debt | 7,625 | 1,435 |
| Short-term bank debt | 1,039 | 226 |
| | <u> </u> | <u> </u> |
| Total long-term debt | \$ 217,345 | \$ 138,060 |
| | <u> </u> | <u> </u> |

In connection with the Paravant merger, on November 26, 2002 the Company entered into a \$338.6 million amended and restated credit agreement (Credit Facility). Wachovia Bank, National Association is the Administrative Agent under the amended and restated credit agreement. The amended credit facility consists of a \$125 million senior secured revolving line of credit and a \$213.6 million senior secured term loan facility. The maturity dates of the term loan and the revolving credit facility are September 30, 2008 and September 30, 2006, respectively. The term loan requires quarterly principal payments, which began with a \$537,500 payment on December 31, 2002. The Credit Facility is secured by a lien on substantially all of DRS's assets. Borrowings under this Credit Facility bear interest, at the Company's option, at either: a "base rate", as defined in the credit agreement, equal to the higher of 0.50% per annum above the latest prime rate and federal funds rate plus a spread ranging from 1.25% to 2.25% per annum, depending on the Company's total leverage ratio (TLR) at the time of determination; or a LIBOR rate, as defined in the Credit Facility, plus a spread ranging from 2.25% to 3.25% per annum, depending on the Company's TLR. The TLR is defined as total debt minus performance-based letters of credit, as compared with EBITDA, as defined in the credit agreement.

The Company previously had a \$240 million credit agreement with a syndicate of lenders, with Wachovia Bank, National Association as the Administrative Agent, consisting of a term loan in the aggregate principal amount of \$140 million and a \$100 million revolving line of credit. Repayment terms and interest rates under the previous facility were substantially the same as those pursuant to the amended and restated credit agreement described above.

There are certain covenants and restrictions placed on DRS under its Credit Facility, including a maximum TLR and a minimum fixed-charge ratio, a maximum amount of capital expenditures, a restriction on the payment of dividends on DRS's capital stock, a limitation on the issuance of additional debt, a requirement that the Company offer to make prepayments on its term loans outstanding with 50% of the aggregate net cash proceeds from any equity offering if DRS's adjusted leverage ratio exceeds 2.00 to 1.00, and certain other restrictions. The Company was in compliance with all covenants under its Credit Facility at December 31, 2002. As of December 31, 2002, the Company had approximately \$105.3 million of additional available credit, after satisfaction of its borrowing base requirement.

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As of December 31, 2002, \$213.1 million of term loans were outstanding against the Credit Facility, with a weighted average interest rate of approximately 4.7%. In addition to the term loans, \$19.7 million was contingently payable under outstanding letters of credit. The Company enters into standby letter-of-credit agreements with financial institutions and customers primarily relating to the guarantee of future performance on certain contracts to provide products and services and to secure advanced payments it has received from customers. There were no borrowings under the Company's revolving line of credit as of December 31, 2002.

7. Earnings Per Share

The following table presents the computation of basic and diluted earnings per share (EPS):

| | Three Months Ended December 31, | | Nine Months Ended December 31, | |
|--|------------------------------------|-------------|-----------------------------------|-------------|
| | <u>2002</u> | <u>2001</u> | <u>2002</u> | <u>2001</u> |

(in thousands, except per-share data)

| | | | | |
|------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| Basic EPS computation: | | | | |
| Net earnings | \$ 7,406 | \$ 5,371 | \$ 20,503 | \$ 13,752 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

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| | Three Months Ended December 31, | | Nine Months Ended December 31, | |
|---|------------------------------------|----------|-----------------------------------|-----------|
| | | | | |
| Weighted average common shares outstanding | 17,592 | 12,833 | 17,100 | 12,357 |
| Basic earnings per share | \$ 0.42 | \$ 0.42 | \$ 1.20 | \$ 1.11 |
| Diluted EPS computation: | | | | |
| Net earnings | \$ 7,406 | \$ 5,371 | \$ 20,503 | \$ 13,752 |
| Diluted common shares outstanding: | | | | |
| Weighted average common shares outstanding | 17,592 | 12,833 | 17,100 | 12,357 |
| Stock options and warrants | 620 | 1,300 | 710 | 1,093 |
| Weighted average diluted shares outstanding | 18,212 | 14,133 | 17,810 | 13,450 |
| Diluted earnings per share | \$ 0.41 | \$ 0.38 | \$ 1.15 | \$ 1.02 |

8. Comprehensive Earnings

The components of comprehensive earnings for the three- and nine-month periods ended December 31, 2002 and 2001 consisted of the following:

| | Three Months Ended December 31, | | Nine Months Ended December 31, | |
|---|------------------------------------|----------|-----------------------------------|-----------|
| | 2002 | 2001 | 2002 | 2001 |
| (in thousands) | | | | |
| Net earnings | \$ 7,406 | \$ 5,371 | \$ 20,503 | \$ 13,752 |
| Other comprehensive earnings (losses): | | | | |
| Foreign currency translation adjustments | 510 | 149 | 2,606 | 951 |
| Unrealized losses on hedging instruments: | | | | |
| Cumulative adjustment at April 1, 2001 | | | | (289) |
| Unrealized gains (losses) arising during the period | 245 | 4 | 391 | (501) |
| Comprehensive earnings | \$ 8,161 | \$ 5,524 | \$ 23,500 | \$ 13,913 |

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9. Operating Segments

DRS operates in three principal business segments on the basis of products and services offered: the Electronic Systems Group (ESG), the Electro-Optical Systems Group (EOSG), and the Flight Safety and Communications Group (FSCG). All other operations are grouped in "Other." Information about the Company's segments for the fiscal periods ended December 31, 2002 and 2001 is as follows:

| | ESG | EOSG | FSCG | Other | Total |
|--|-----------|-----------|-----------|--------|------------|
| (in thousands) | | | | | |
| Quarter Ended December 31, 2002 | | | | | |
| Total revenues | \$ 80,356 | \$ 62,224 | \$ 26,226 | \$ 669 | \$ 169,475 |

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| | ESG | EOSG | FSCG | Other | Total |
|--|------------|------------|------------|------------|------------|
| Intersegment revenues | (141) | (21) | (1,773) | | (1,935) |
| External revenues | \$ 80,215 | \$ 62,203 | \$ 24,453 | \$ 669 | \$ 167,540 |
| Operating income (loss) | \$ 6,485 | \$ 7,466 | \$ 2,766 | \$ (147) | \$ 16,570 |
| Identifiable assets | \$ 397,326 | \$ 281,514 | \$ 103,726 | \$ 157,228 | \$ 939,794 |
| Depreciation and amortization | \$ 1,067 | \$ 2,427 | \$ 518 | \$ 414 | \$ 4,426 |
| Capital expenditures | \$ 937 | \$ 1,486 | \$ 164 | \$ 1,293 | \$ 3,880 |
| Quarter Ended December 31, 2001 | | | | | |
| Total revenues | \$ 53,160 | \$ 60,557 | \$ 27,606 | \$ 2,364 | \$ 143,687 |
| Intersegment revenues | (20) | (540) | (1,889) | | (2,449) |
| External revenues | \$ 53,140 | \$ 60,017 | \$ 25,717 | \$ 2,364 | \$ 141,238 |
| Operating income (loss) | \$ 4,315 | \$ 7,188 | \$ 2,636 | \$ (261) | \$ 13,878 |
| Identifiable assets | \$ 125,298 | \$ 199,390 | \$ 104,290 | \$ 113,616 | \$ 542,594 |
| Depreciation and amortization | \$ 462 | \$ 2,312 | \$ 477 | \$ 383 | \$ 3,634 |
| Capital expenditures | \$ 527 | \$ 2,163 | \$ 170 | \$ 147 | \$ 3,007 |
| Nine Months Ended December 31, 2002 | | | | | |
| Total revenues | \$ 184,312 | \$ 198,953 | \$ 78,780 | \$ 3,039 | \$ 465,084 |
| Intersegment revenues | (223) | (219) | (4,668) | | (5,110) |
| External revenues | \$ 184,089 | \$ 198,734 | \$ 74,112 | \$ 3,039 | \$ 459,974 |
| Operating income (loss) | \$ 12,111 | \$ 27,596 | \$ 7,758 | \$ (1,499) | \$ 45,966 |
| Identifiable assets | \$ 397,326 | \$ 281,514 | \$ 103,726 | \$ 157,228 | \$ 939,794 |
| Depreciation and amortization | \$ 2,885 | \$ 6,398 | \$ 1,687 | \$ 1,042 | \$ 12,012 |
| Capital expenditures | \$ 1,980 | \$ 7,850 | \$ 535 | \$ 2,831 | \$ 13,196 |
| Nine Months Ended December 31, 2001 | | | | | |
| Total revenues | \$ 144,376 | \$ 143,227 | \$ 71,916 | \$ 6,848 | \$ 366,367 |
| Intersegment revenues | (37) | (1,004) | (4,558) | | (5,599) |
| External revenues | \$ 144,339 | \$ 142,223 | \$ 67,358 | \$ 6,848 | \$ 360,768 |
| Operating income (loss) | \$ 13,349 | \$ 17,005 | \$ 4,920 | \$ (1,009) | \$ 34,265 |
| Identifiable assets | \$ 125,298 | \$ 199,390 | \$ 104,290 | \$ 113,616 | \$ 542,594 |
| Depreciation and amortization | \$ 1,271 | \$ 4,851 | \$ 2,149 | \$ 1,325 | \$ 9,596 |
| Capital expenditures | \$ 1,782 | \$ 6,212 | \$ 1,183 | \$ 1,310 | \$ 10,487 |

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10. Supplemental Cash Flow Information

| | Nine Months Ended December 31, | |
|---|-----------------------------------|-----------|
| | 2002 | 2001 |
| (in thousands) | | |
| Cash paid for: | | |
| Income taxes | \$ 9,465 | \$ 10,470 |
| Interest | \$ 8,156 | \$ 6,881 |
| Noncash investing and financing activities: | | |
| Note receivable sale of operating unit | \$ 3,010 | \$ |
| Acquisition costs for business combinations | \$ 5,590 | \$ 2,438 |
| Promissory note Nytech acquisition | \$ 8,000 | \$ |

11. Contingencies

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The Company is a party to various legal actions and claims arising in the ordinary course of its business. In the Company's opinion, the Company has adequate legal defenses for each of the actions and claims, and believes that their ultimate disposition will not have a material adverse effect on the Company's consolidated financial position, results of operations or liquidity.

The Company recently settled a dispute with Spar Aerospace Ltd. with respect to the working capital adjustment provided for in the purchase agreement between DRS and Spar dated as of September 19, 1997, pursuant to which the Company acquired, through certain of its subsidiaries, certain assets of Spar. Under the terms of this settlement, DRS agreed to pay Spar a working capital adjustment of CAN\$4,616,000 (or approximately \$3,000,000) and CAN\$723,654 (or approximately \$460,000) in interest. During fiscal 2002, the Company accrued \$3.9 million, including interest, associated with the dispute. In connection with this settlement, the parties agreed to release each other from all claims arising out of or relating to the working capital adjustment provision in the purchase agreement and to discontinue all legal actions relating thereto.

On October 3, 2001, a lawsuit was filed in the United States District Court of the Eastern District of New York by Miltope Corporation, a corporation of the State of Alabama, and IV Phoenix Group, Inc., a corporation of the State of New York, against DRS Technologies, Inc., DRS Electronic Systems, Inc. and a number of individual defendants, several of whom are employed by DRS Electronic Systems, Inc. The plaintiffs allege claims against the Company of infringement of a number of patents, breach of a confidentiality agreement, misappropriation of trade secrets, unjust enrichment and unfair competition. The claims relate generally to the activities of certain former employees of IV Phoenix Group and the hiring of some of those employees by DRS. The plaintiffs seek damages of not less than \$5.0 million for each of the claims. The plaintiffs also allege claims for tortious interference with business relationships, tortious interference with contracts and conspiracy to breach fiduciary duty. The plaintiffs seek damages of not less than \$47.1 million for each claim. In addition, plaintiffs seek punitive and treble damages, injunctive relief and attorney's fees. In our answer, the Company has denied the plaintiffs' allegations and intends to vigorously defend this action. In February 2002, plaintiffs filed an amended complaint, which eliminated the patent infringement claims and added claims related to statutory and common-law trademark infringement. Although this action is still in

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discovery, the Company believes that it has meritorious defenses and does not believe the action will have a material adverse effect on its earnings, financial condition or liquidity.

12. Recently Issued Accounting Pronouncement

In December 2002, the Financial Accounting Standards Board issued Statement No. 148, "Accounting for Stock-Based Compensation Transition disclosure, An Amendment of FASB Statement No. 123" (SFAS 148). This statement provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of Statement No. 123 to require more prominent and more frequent disclosures in financial statements about the effects of stock-based compensation. The provisions of SFAS 148 are effective for fiscal years ending after December 15, 2002, and the interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. The Company will adopt the disclosure provisions of SFAS 148 for the fiscal year ending March 31, 2003. The adoption of SFAS 148 will not have an impact on the Company's results of operations or financial position as the Company does not plan to change its method of accounting for stock-based compensation.

In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" (SFAS 146). SFAS 146 requires Companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Previous accounting guidance was provided by EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)" (EITF 94-3). SFAS 146 replaces EITF 94-3. The Statement is to be applied prospectively to exit or disposal activities initiated after December 31, 2002.

In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations" (SFAS 143). SFAS 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The purpose of SFAS No. 143 is to develop consistent accounting of asset retirement obligations and related costs in the financial statements and to provide more information about future cash outflows, leverage, and liquidity regarding retirement obligations and the gross investment in long-lived assets. SFAS No. 143 is effective for financial statements issued for fiscal years beginning after June 15, 2002. The Company is in the process of evaluating SFAS 143 and does not anticipate that the adoption of the statement will have a material effect on its results of operations or financial position.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following is management's discussion and analysis (MD&A) of the consolidated financial condition and results of operations of DRS Technologies, Inc. and Subsidiaries (hereinafter, we, us, our, the Company or DRS) as of December 31, 2002, and for the three- and nine-month periods ended December 31, 2002 and 2001. This discussion should be read in conjunction with the audited consolidated financial statements and related notes contained in our March 31, 2002 Form 10-K.

Forward-Looking Statements

The following discussion and analysis contains forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that are based on management's beliefs and assumptions, current expectations, estimates and projections. Such statements, including statements relating to the Company's expectations for future financial performance, are not considered historical facts and are considered forward-looking statements under the federal securities laws. These statements may contain words such as "believes," "anticipates," "plans," "expects," "intends," "estimates" or similar expressions. These statements are not guarantees of the Company's future performance and are subject to risks, uncertainties and other important factors that could cause our actual performance or achievements to differ materially from those expressed or implied by these forward-looking statements and include, without limitation: the effect of our acquisition strategy on future operating results, including our ability to effectively integrate acquired companies into our existing operations; the uncertainty of acceptance of new products and successful bidding for new contracts; the effect of technological changes or obsolescence relating to our products and services; and the effects of government regulation or shifts in government policy, as they may relate to our products and services and other risks or uncertainties detailed in the Company's Securities and Exchange Commission filings. Given these uncertainties, you should not rely on forward-looking statements. The Company undertakes no obligations to update any forward-looking statements, whether as a result of new information, future events or otherwise.

Overview

DRS is a leading supplier of defense electronics products and systems. We provide high-technology products and services to all branches of the U.S. military, major aerospace and defense prime contractors, government intelligence agencies, international military forces and industrial customers. Incorporated in 1968, we have served the defense industry for over 30 years. We are a leading provider of thermal imaging devices, combat display workstations, electronic sensor systems, electrical power conversion equipment, ship controls, networks and propulsion systems, ruggedized computers, mission recorders and deployable flight incident recorders. Our products are deployed on a wide range of high-profile military platforms, including every combatant ship in the U.S. Navy, Virginia class submarines, M1A2 Abrams Main Battle Tanks, M2A3 Bradley Fighting Vehicles, OH-58D Kiowa Warrior helicopters, F/A-18E/F Super Hornet attack aircraft, as well as for other military and non-military applications.

Company Organization and Products

We operate in three principal operating segments on the basis of products and services offered. Each operating segment is comprised of separate and distinct businesses: the Electronic Systems Group, the Electro-Optical Systems Group and the Flight Safety and Communications Group. All other operations are grouped in Other.

Our Electronic Systems Group (ESG) is a supplier of computer workstations used to process and display integrated combat information. ESG produces rugged computers and peripherals, surveillance,

radar and tracking systems, radar support and antennae systems, acoustic signal processing and display equipment, and combat control systems. ESG is also a leader in power conversion equipment, electric drive control systems and specialty devices for nuclear reactor applications for the U.S. Navy and industrial customers. The Group's products are used on U.S. Navy front-line platforms, including Aegis surface ships, aircraft carriers, attack submarines, surveillance aircraft and amphibious operation platforms. ESG's products also are used in U.S. Army and international battlefield digitization programs.

Our Electro-Optical Systems Group (EOSG) produces infrared night vision and targeting systems and subsystems used on the U.S. Army's Abrams Main Battle Tanks, Bradley Fighting Vehicles, OH-58D Kiowa Warrior helicopters, Aegis destroyers and cruisers and High-Mobility Multipurpose Wheeled Vehicle Scouts and used by command, brigade and soldier ground forces. EOSG designs, manufactures and markets these and other products that allow operators and surveillance platforms, such as satellites, to detect, identify and target objects based upon their infrared signatures, regardless of the ambient light level. This Group is one of two key suppliers to the U.S. government for advanced focal plane

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array technology. In addition to military applications, EOSG also manufactures electro-optical modules for commercial devices used in corrective laser eye surgery and provides system integration for retinal scanning and imaging devices.

Our Flight Safety and Communications Group (FSCG) is a manufacturer of airborne deployable recorders and surveillance and communications systems. FSCG's products are used by U.S. and international militaries, as well as commercial customers. FSCG produces integrated naval ship communications systems, tactical data systems, mission recorders, coastal and border radar surveillance systems, ultra high-speed digital imaging systems for F/A-18 aircraft and industrial purposes, and multiple-platform weapons calibration systems for air platforms, such as the AH-64 Apache attack helicopter and the AC-130U gunship. The Group also provides electronic manufacturing services to the defense and space industries.

Other includes the activities of DRS Corporate Headquarters, DRS Unmanned Technologies (see Business Combinations and Disposals), DRS Ahead Technology (for the period it was owned by us during the first quarter of fiscal 2003) and certain non-operating subsidiaries of the Company. The assets of DRS Ahead Technology were sold on May 27, 2002 (see Business Combinations and Disposals). DRS Unmanned Technologies provides close-range, low-weight, low-noise, medium-duration unmanned aerial vehicles (UAVs) supporting military special operations missions.

Business Combinations and Disposals

On January 15, 2003, we acquired the assets and certain liabilities of the Electromagnetics Development Center of Kaman Aerospace, a subsidiary of Kaman Corporation, located in Hudson, Massachusetts, for \$27.5 million in cash, subject to adjustment, plus \$7.5 million of contingent consideration. Contingent consideration is based on a funded booking milestone, as defined in the purchase agreement. If the funded booking milestone is not fulfilled on or before December 31, 2008, we would have no liability or obligation to pay any contingent consideration. The earn-out period began on the closing date of the acquisition. Kaman's Electromagnetics Development Center is a leader in the development of high-performance, lightweight electric motors, generators and drive electronics for defense, industrial and transportation applications. Renamed DRS Electric Power Technologies, the company operates as part of our Electronic Systems Group (ESG). The addition of DRS Electric Power Technologies is complementary to our existing position in ship electric propulsion equipment, control equipment, high-performance networks, tactical displays and specialty reactor plant instrumentation.

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On November 27, 2002, a wholly-owned subsidiary of ours merged with and into Paravant Inc. (Paravant), with Paravant being the surviving corporation and continuing as a wholly-owned subsidiary of DRS. Consideration in the Paravant acquisition was approximately \$92.9 million in cash and the assumption of approximately \$15.9 million in debt. In addition to the purchase price, the estimated costs relating to the acquisition, including professional fees, approximated \$4.0 million. The Company financed the acquisition with borrowings under its credit facility. Paravant is a designer and manufacturer of highly engineered, technically advanced, defense electronics for U.S. and allied international military and intelligence agency applications. Headquartered in Morristown, New Jersey, the company manufactures rugged computer systems and communications interfaces serving military Command, Control, Communications, Computer, Intelligence and Surveillance (C4ISR) initiatives. Paravant also produces high-speed processing equipment for the intelligence community and offers modernization design and installation services for select rotary- and fixed-wing military aircraft. The Paravant acquisition is highly compatible with our goals of expanding its core tactical systems business base and increasing our presence in the U.S. Air Force and high-end signal intelligence programs supporting government agencies.

We are in the process of obtaining third-party valuations of certain assets acquired, as well as performing our own internal assessment; thus, the preliminary allocation of the purchase price will change. Based on preliminary allocations, we have estimated goodwill to be approximately \$91.4 million. It is our expectation that upon completion of our internal assessment the preliminary allocation of the purchase price to goodwill will increase. We expect to complete the purchase price allocation in the fourth quarter of fiscal 2003.

On November 22, 2002, we sold our DRS Advanced Programs, Inc. operating unit (DRS API) for \$7.6 million in cash and recorded a \$0.6 million loss on the sale. DRS API, located in Columbia, Maryland, operated as part of our ESG operating segment and develops, designs, manufactures and markets custom-packaged computers and peripherals, primarily for the Department of Defense and the government intelligence community. We wrote off \$2.3 million of goodwill in connection with the sale. The results of operations of DRS API for the period of time that we owned it are summarized as follows:

| Three Months Ended December 31, | | Nine Months Ended December 31, | |
|------------------------------------|------|-----------------------------------|------|
| 2002 | 2001 | 2002 | 2001 |

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| | Three Months Ended December 31, | | Nine Months Ended December 31, | |
|--|------------------------------------|----|-----------------------------------|----|
| | \$ | \$ | \$ | \$ |

(in thousands)

| | | | | |
|----------------|----------|----------|------------|-----------|
| Revenues | \$ 1,814 | \$ 2,806 | \$ 8,507 | \$ 10,731 |
| Operating loss | \$ (348) | \$ (421) | \$ (1,064) | \$ (192) |

On October 15, 2002, we acquired DKD, Inc. (which operated under the name Nytech) for \$13.0 million plus contingent consideration. The \$13.0 million consists of a \$5.0 million cash payment and an \$8.0 million promissory note, bearing interest at a rate of 6%, with payments of \$5.0 million and \$3.0 million due on the first and second anniversaries of the closing, respectively. In addition to the purchase price, the estimated costs related to the acquisition, including professional fees, approximated \$0.5 million. Contingent consideration is based on an aggregate bookings earn-out, as defined in the purchase agreement, and is not to exceed \$17.0 million in the aggregate. The earn-out period began on the closing date of the acquisition and ends on March 31, 2009. Renamed DRS Nytech Imaging Systems, Inc. and located in Irvine, California, the company manufactures and markets uncooled thermal imaging systems for portable weapons, head gear, hand-held devices and vehicle-mounted sights. The business also specializes in the design of stabilized, lightweight gimbals capable of controlling numerous sensors and suitable for mounting on a variety of land, sea and air platforms. The Nytech acquisition enhances our position as a supplier of lightweight thermal imaging systems and supports our objectives to further expand our position in the uncooled infrared technology market. We

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are in process of obtaining third-party valuations of the assets acquired and liabilities assumed, as well as performing our own internal assessment of the acquired contracts; thus, the preliminary allocation of the purchase price may change. Based on preliminary purchase price allocations, we have estimated goodwill to be approximately \$13.1 million and we have allocated the estimated goodwill to our EOSG operating segment. We expect to complete the purchase price allocation in the first quarter of fiscal 2004.

Pursuant to a purchase agreement effective July 1, 2002, the Company acquired the assets and assumed certain liabilities of the Navy Controls Division (NCD) of Eaton Corporation for \$92.2 million in cash, subject to adjustment. In addition to the purchase price, the estimated costs related to the acquisition, including professional fees, approximated \$3.5 million. The Company financed the acquisition with existing cash on hand. Renamed DRS Power & Control Technologies, Inc. (DRS PCT) and located in Milwaukee, Wisconsin, and Danbury, Connecticut, the company is a leading supplier of high-performance power conversion and instrumentation and control systems for the U.S. Navy's combatant fleet, including nuclear-powered and conventionally powered ships, as well as for specialized industrial customers. Products include ship electric propulsion equipment, power electronics equipment, high-performance networks, shipboard control equipment and control panels, tactical displays, and specialty reactor instrumentation and control equipment. The addition of this unit complements our presence in naval advanced command and control computer display and other ship systems. DRS PCT is being managed as a part of our ESG operating segment.

With the exception of establishing the acquired pension asset, the NCD purchase price allocation is final. We are in the process of obtaining a third party pension valuation, accordingly, the purchase price allocation is subject to change in the fourth quarter of fiscal 2003. Based upon our purchase price allocation as of December 31, 2002, the excess of costs over the net amounts allocated to the assets acquired and liabilities assumed in the acquisition (goodwill) and the appraised value of certain identifiable intangible assets were approximately \$96.1 million and \$6.6 million, respectively, with the identifiable intangible assets being amortized over 20 years. The goodwill was allocated to our ESG operating segment.

On May 27, 2002, we sold the assets of our DRS Ahead Technology operating unit. The operating unit produced magnetic head components used in the manufacturing process of computer disk drives and manufactured magnetic video recording heads used in broadcast television equipment. DRS Ahead Technology recorded \$1.3 million of revenues and \$0.4 million of operating loss for the period it was owned by us during the first quarter of fiscal 2003. The operating unit recorded \$2.4 million of revenues and \$0.1 million of operating loss for the third quarter of fiscal 2002, and \$6.8 million and \$0.6 million of revenues and operating losses, respectively, during the nine-month period ended December 31, 2001. The assets of DRS Ahead Technology were sold for their aggregate book value, and we received an interest bearing promissory note in the amount of \$3.1 million as consideration for the sale. The promissory note bears interest and is payable over an 80-month term. No gain or loss was recorded on the sale.

On April 11, 2002, we acquired the assets of the U.S.-based Unmanned Aerial Vehicle (UAV) business of Meggitt Defense Systems Texas, Inc., a unit of Meggitt plc, for \$0.8 million in cash. In addition to the purchase price, the costs related to the acquisition were approximately \$0.2 million. The business, located in Mineral Wells, Texas, and now operating as DRS Unmanned Technologies, Inc., provides close-range, low-weight, low-noise, medium-duration UAVs supporting military special operations missions. Applications for these products include tactical short-range surveillance, radio relay, and command, control, communications, computers, intelligence, surveillance and

reconnaissance. The preliminary estimate of the excess of costs over the net amounts allocated to the assets acquired and liabilities assumed in the acquisition (goodwill) and the appraised value of an identifiable intangible asset were approximately \$0.3 million and \$0.3 million, respectively. The goodwill has been

allocated to our "Other" operating segment. The identifiable intangible asset has an indefinite useful life. We are in the process of finalizing our own internal assessment of the acquired contracts; thus, the preliminary allocation of the purchase price will likely change. We will complete the purchase price allocation in the fourth quarter of fiscal 2003.

All of our acquisitions have been accounted for as purchase business combinations and are included in our consolidated results of operations from their respective acquisition dates.

Critical Accounting Policies

Our consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America. Preparing consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. These estimates and assumptions are affected by the application of our accounting policies. Our significant accounting policies are described in Note 1 to the March 31, 2002 consolidated financial statements included in our Form 10-K. Critical accounting policies are those that require application of management's most difficult, subjective or complex judgments, often as a result of matters that are inherently uncertain and may change in subsequent periods. Critical accounting policies for us include revenue recognition on contracts and contract estimates, goodwill and intangible assets, long-lived assets and acquired intangible assets, valuation of deferred tax assets and liabilities, and management estimates. For additional discussion of our critical accounting policies, see our MD&A in our March 31, 2002 Form 10-K.

Results of Operations

Our operating cycle is long-term and involves various types of production contracts and varying production delivery schedules. Accordingly, results of a particular quarter or quarter-to-quarter comparisons of recorded revenues and earnings may not be indicative of future operating results. The following comparative analysis should be viewed in this context.

Consolidated Summary

Three- and Nine-Month Periods Ended December 31, 2002, Compared with the Three- and Nine-Month Periods Ended December 31, 2001

Consolidated revenues and operating income for the three-month period ended December 31, 2002 were \$167.5 million and \$16.6 million, each of which increased by 19% over the corresponding prior-year period. The increase in third quarter revenues was driven by our July 1, 2002 acquisition of the Navy Controls Division of Eaton Corporation (now operating as DRS Power and Control Technologies, Inc.), our November 27, 2002 acquisition of Paravant Inc. (Paravant) and our October 15, 2002 acquisition of Nytech. DRS Power and Control Technologies, Inc. (DRS PCT), Paravant and Nytech contributed \$24.9 million, \$8.0 million and \$1.0 million, respectively, to fiscal 2003 third quarter revenues. Increased revenues from our ground vehicle electro-optical systems also contributed to the increase. Partially offsetting the overall increase in revenues were decreases from our combat display workstations, certain rugged computer and peripheral programs, the May 27, 2002 sale of DRS Ahead Technology and the November 22, 2002 sale of DRS API. DRS API recorded \$1.8 million of revenue in the third quarter of fiscal 2003 while in the third quarter of fiscal 2002 DRS Ahead Technology and DRS API, combined, recorded \$5.2 million of revenue. The growth in operating income was due primarily to DRS PCT and Paravant, which contributed, net of corporate allocations, \$3.3 million and \$0.8 million, respectively, to operating income in the third quarter of fiscal 2003. See operating segment discussions below for additional information.

Consolidated revenues and operating income for the nine-month period ended December 31, 2002 were \$460.0 million and \$46.0 million, increases of 27% and 34%, respectively, over the corresponding prior-year period. The increase in year-to-date revenues was primarily a result of our fiscal 2003 acquisitions of DRS PCT and Paravant, as well as the benefit of a full nine months of revenues from our September 28, 2001 acquisition of the Sensors and Electronic Systems Business of The Boeing Company (the SES business). DRS PCT and Paravant contributed

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\$49.5 million and \$8.0 million, respectively, of revenues to the nine-month period ended December 31, 2002. The SES business contributed an incremental increase (i.e., current year-to-date period over prior year-to-date period) of \$34.3 million to revenues for the nine-month period ended December 31, 2002. In addition, increased shipments of our ground vehicle electro-optical systems, mission data recorders and avionics contributed to the increase in revenues for the nine-month period ended December 31, 2002. Partially offsetting the overall increase in revenues were decreases from our combat display workstations, certain rugged computers and peripherals programs and the sale of DRS Ahead Technology and DRS API. DRS Ahead Technology and DRS API, combined, recorded revenues of \$9.9 million in the nine months ended December 31, 2002, as compared with \$17.6 million in the same period in the prior year. The growth in operating income was due primarily to the overall increase in revenues. Net of corporate allocations, DRS PCT and Paravant contributed \$5.4 million and \$0.8 million, respectively, to operating income in the nine months ended December 31, 2002, while the SES business contributed an incremental increase of \$2.6 million to operating income for the same period. See operating segment discussions below for additional information.

Interest income increased \$0.1 million and \$0.8 million for the three- and nine-month periods ended December 31, 2002, as compared with the prior-year periods. The increases in interest income reflect higher average cash and cash equivalents balances during the quarter and year-to-date periods, resulting primarily from our common stock offerings in December 2002 and 2001.

Interest and related expenses decreased \$0.6 million for the three-month period ended December 31, 2002, as compared with same period ended December 31, 2001, and increased \$0.2 million for the nine-month period ended December 31, 2002, as compared with the corresponding prior year period. The quarter-on-quarter decrease in interest expense was primarily a result of fiscal 2002 third quarter interest expense recorded in connection with estimated working capital adjustments associated with certain acquisitions completed in prior fiscal years, as well as an overall decrease in weighted average interest rates in our term loan borrowings. The increase in interest expense in the year-to-date period was attributable to an overall increase in average borrowings outstanding in the first nine months of fiscal 2003, as compared with the same period in the prior fiscal year. The overall increase in our average borrowings was a result of our November 27, 2002 acquisition of Paravant. Partially offsetting the increase in interest expense was the favorable impact of an overall decrease in weighted average interest rates on our outstanding borrowings during fiscal 2003, as compared with the prior fiscal year. We had no borrowings outstanding under our revolving credit facility as of December 31, 2002.

The provision for income taxes for the quarter and year-to-date periods ended December 31, 2002 reflect an annual estimated effective income tax rate of approximately 46%, as compared with 47% in the prior-year period. There are two primary factors that negatively impact our effective income tax rate: losses in ESG's U.K. operation for which the full tax benefit has not been recognized, and the effect of non-deductible expenses. It is anticipated that our effective tax rate will continue to decline moderately in future years, as we continue to grow and our ESG U.K. operation returns to profitability.

Earnings before net interest and related expenses (primarily amortization of debt issuance costs), income taxes, depreciation and amortization (EBITDA) for the three- and nine-month periods ended December 31, 2002 were \$20.6 million and \$56.5 million, respectively, increases of 21% and 32%, respectively, over the same periods in the prior year. EBITDA is not a substitute for operating income,

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net earnings or cash flows from operating activities, as determined in accordance with accounting principles generally accepted in the United States of America, or as a measure of our profitability or liquidity. We present EBITDA as additional information because we believe it to be a useful indicator of our ability to meet debt service and capital expenditure requirements. EBITDA, as we define it, may differ from similarly named measures used by other entities.

Operating Segments

The following tables set forth, by operating segment, revenues, operating income and operating margin, and the percentage increase or decrease of those items, as compared with the prior-year period:

| Three Months Ended December 31, | | Three Months Ended Percent Changes | Nine Months Ended December 31, | | Nine Months Ended Percent Changes |
|------------------------------------|------|--|-----------------------------------|------|---|
| 2002 | 2001 | 2002 vs. 2001 | 2002 | 2001 | 2002 vs. 2001 |
| | | | | | |

(in thousands, except for percentages)

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| | Three Months Ended December 31, | | Three Months Ended Percent Changes | Nine Months Ended December 31, | | Nine Months Ended Percent Changes |
|-------------------|------------------------------------|-----------|--|-----------------------------------|------------|---|
| External revenues | \$ 80,215 | \$ 53,140 | 51.0% | \$ 184,089 | \$ 144,339 | 27.5% |
| Operating income | \$ 6,485 | \$ 4,315 | 50.3% | \$ 12,111 | \$ 13,349 | (9.3%) |
| Operating margin | 8.1% | 8.1% | 0.0% | 6.6% | 9.2% | (28.3%) |
| EOSG | | | | | | |
| External revenues | \$ 62,203 | \$ 60,017 | 3.6% | \$ 198,734 | \$ 142,223 | 39.7% |
| Operating income | \$ 7,466 | \$ 7,188 | 3.9% | \$ 27,596 | \$ 17,005 | 62.3% |
| Operating margin | 12.0% | 12.0% | 0.0% | 13.9% | 12.0% | 15.8% |
| FSCG | | | | | | |
| External revenues | \$ 24,453 | \$ 25,717 | (4.9%) | \$ 74,112 | \$ 67,358 | 10.0% |
| Operating income | \$ 2,766 | \$ 2,636 | 4.9% | \$ 7,758 | \$ 4,920 | 57.7% |
| Operating margin | 11.3% | 10.3% | 9.7% | 10.5% | 7.3% | 43.8% |
| Other | | | | | | |
| External revenues | \$ 669 | \$ 2,364 | (71.7%) | \$ 3,039 | \$ 6,848 | (55.6%) |
| Operating loss | \$ (147) | \$ (261) | 43.7% | \$ (1,499) | \$ (1,009) | (48.6%) |
| Operating margin | (22.0%) | (11.0%) | (100.0%) | (49.3%) | (14.7%) | (235.4%) |

Three- and Nine-Month Periods Ended December 31, 2002, Compared with the Three- and Nine-Month Periods Ended December 31, 2001

Electronic Systems Group

Revenues increased \$27.1 million, or 51%, to \$80.2 million in the three months ended December 31, 2002, as compared with the corresponding prior-year period. Fiscal 2003 third quarter operating income increased \$2.2 million or 50% to \$6.5 million, as compared with same period in the prior fiscal year. The increase in revenues was a result of our acquisitions of DRS PCT and Paravant, which contributed \$24.9 million and \$8.0 million, respectively, of revenues in the current quarter. In addition to the acquisition, revenue was favorably impacted by increased sales of rugged computers and multi-function consoles from our U.K. operating unit. Partially offsetting the overall increase in revenues were decreased shipments of combat display workstations and components and certain rugged computers and peripherals, as well as our sale of DRS API, as discussed above. The increase in operating income was driven by the DRS PCT and Paravant acquisitions, partially offset by the impact of decreased sales on certain programs previously noted and a \$0.6 loss recorded in connection with the sale of DRS API. DRS PCT and Paravant contributed, net of corporate allocations, \$3.3 million and \$0.8 million, respectively, of operating income to the current quarter.

Revenues increased \$39.8 million, or 28%, to \$184.1 million in the nine months ended December 31, 2002, as compared with the corresponding prior-year period. Operating income decreased \$1.2 million, or 9%, to \$12.1 million. The increase in revenues was due to the DRS PCT and Paravant acquisitions, which contributed revenues of \$49.5 million and \$8.0 million, respectively, as well as to the benefit of a full nine months of revenues from our August 2001 acquisition of the Electro Mechanical Systems unit of Lockheed Martin (EMS), which made an incremental revenue contribution of \$5.7 million. Also favorably impacting year-to-date revenues were increased sales of rugged computers and multi-function consoles from our U.K. operating unit. Partially offsetting the increase in revenues was a decrease in shipments of combat display workstations, rugged computers and peripherals. The decrease in operating income was driven by the unfavorable impact of decreased revenue from certain products, as discussed above, as well as \$2.0 million of charges at ESG's U.K. operating unit. The charges included \$1.7 million for cost growth and inventory write-offs on certain programs and \$0.3 million for employee severance. DRS PCT and Paravant contributed \$5.4 million and \$0.8 million, respectively, of operating income to the nine months ended December 31, 2002.

Electro-Optical Systems Group

Revenues increased \$2.2 million, or 4%, to \$62.2 million in the three months ended December 31, 2002, as compared with the corresponding prior-year period. Operating income increased \$0.3 million to \$7.5 million. The increase in revenues was driven by our fiscal 2003 third quarter acquisition of DKD, Inc. (which operated under the name Nytech), now operating as DRS Nytech Imaging Systems, Inc. (DRS Nytech), and internal growth from our ground-based infrared targeting and imaging systems. The programs we acquired with the DRS Nytech acquisition generated \$1.0 million of revenues in the third quarter of fiscal 2003. Operating income was favorably impacted by the

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overall increase in revenues. DRS Nytech generated \$0.1 million of operating income during the current quarter.

Revenues increased \$56.5 million, or 40%, to \$198.7 million in the nine months ended December 31, 2002, as compared with the corresponding prior-year period. Operating income increased \$10.6 million to \$27.6 million. The increase in revenues and operating income were driven by our fiscal 2002 second quarter acquisition of the SES business, our acquisition of Nytech, as well as internal growth from our ground-based infrared targeting and imaging systems. Operating income for the nine months ended December 31, 2002 was also positively impacted by net favorable program adjustments totaling \$1.9 million. Revenue and operating income for the nine months ended December 31, 2002 attributable to the SES business acquisition increased by \$34.3 million and \$2.6 million, respectively, as compared with the prior year period.

Flight Safety and Communications Group

Revenues decreased \$1.3 million, or 5%, to \$24.5 million in the three months ended December 31, 2002, as compared with the corresponding prior-year period. Operating income increased \$0.1 million to \$2.8 million. The decrease in revenue was driven by decreased shipments of surface ship communication systems and high-speed cameras and lower volume in contract manufacturing services. Partially offsetting the overall decrease were revenue increases from international mobile ground surveillance systems and flight data recording products. The increase in operating income was a result of favorable margins from certain communication systems and flight data recording programs. Fiscal 2003 third quarter operating income also included charges of \$1.5 million and \$0.6 million for cost growth on a mission data recorder program and reorganization charges in the operating group's Canadian and U.K. operating subsidiaries, respectively.

Revenues increased \$6.8 million, or 10%, to \$74.1 million in the nine months ended December 31, 2002, as compared with the corresponding prior-year period. Operating income increased \$2.8 million,

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or 58%, to \$7.8 million. Increased shipments of mission data recording systems and avionics products were the primary driver of the increase in revenues. Decreased shipments of certain communication and surveillance systems partially offset the overall increase in revenues. The increase in operating income is a result of higher revenues and favorable margins from certain communication and mission data recording systems. Operating income for the nine months ended December 31, 2002 included charges of \$2.0 million and \$0.8 million for program reserves on a mission data recorder program and reorganization charges in the operating group's Canadian and U.K. operating subsidiaries, respectively. Operating income for the nine months ended December 31, 2001 included charges of \$0.8 million associated with closing a production facility.

Other

Revenues decreased \$1.7 million to \$0.7 million in the three months ended December 31, 2002. The operating loss of \$0.1 million was relatively unchanged, as compared with the corresponding prior-year period. The decrease in revenues was attributable to our sale of substantially all of the assets and liabilities of DRS Ahead Technology on May 27, 2002, partially offset by revenues generated by our April 11, 2002 acquisition of the U.S.-based Unmanned Aerial Vehicle (UAV) business of Meggitt Defense Systems Texas, Inc. (now operating as DRS Unmanned Technologies).

Revenues decreased \$3.8 million to \$3.0 million and operating losses increased \$0.5 million to \$1.5 million for the nine months ended December 31, 2002, as compared with the corresponding prior-year period. Consistent with the quarterly discussion above, the revenue decrease was due to the sale of DRS Ahead Technology, offset in part by revenue from DRS Unmanned Technologies. The increase in operating losses was due to non-allocable general and administrative expenses at DRS Corporate, as well as research and development costs at DRS Unmanned Technologies.

Liquidity and Capital Resources

The following table provides our cash flow data for the nine months ended December 31, 2002 and 2001:

| Nine Months Ended December 31, | |
|-----------------------------------|------|
| 2002 | 2001 |
| | |

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Nine Months Ended
December 31,

(in thousands)

| | | | | |
|---|----|-----------|----|----------|
| Net cash provided by operating activities | \$ | 25,389 | \$ | 13,416 |
| Net cash used in investing activities | \$ | (201,711) | \$ | (83,281) |
| Net cash provided by financing activities | \$ | 205,780 | \$ | 171,032 |

Operating Activities For the nine months ended December 31, 2002, we generated \$25.4 million of operating cash flow, \$12.0 million more than the \$13.4 million reported in the corresponding prior-year period. Cash provided by earnings, net of adjustments for non-cash items, increased \$12.6 million to \$34.8 million.

Changes in working capital accounts used \$9.5 million in cash, as compared with the \$8.8 million used in the corresponding prior-year period. The cash used for working capital accounts resulted from increases in accounts receivable, inventories and other current assets, predominantly progress payments made to vendors for certain long-term electro-optical contracts, and decreases in accrued expenses, which included a payment of \$2.5 million associated with the DRS Photonics, Inc. litigation settlement (see Part I, Item 3 of our March 31, 2002 10-K). These uses were offset, in part, by cash received from customer advances and increases in trade payables.

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Investing Activities We paid \$13.2 million for capital expenditures during the nine months ended December 31, 2002, as compared with \$10.5 million for the corresponding prior-year period. We expect that capital expenditures for fiscal 2003 to be between \$18.0 million and \$22.0 million, as we continue to upgrade our facilities and integrate recent acquisitions into our existing businesses.

During the nine months ended December 31, 2002, we completed several business combinations and sold two of our businesses. The following table summarizes the cash flow impact of our business combinations and divestitures:

| Business Combinations | Date of Transaction | Consideration Paid Through December 31, 2002 | | |
|---|---------------------|---|----------------------|------------|
| | | Paid to Sellers | Acquisition Expenses | Total |
| UAV Business of Meggitt Defense Systems | 4/11/02 | \$ 750 | \$ 108 | \$ 858 |
| Navy Controls Division of Eaton Corporation | 7/1/02 | 92,200 | 2,346 | 94,546 |
| DKD, Inc. (Nytech) | 10/15/02 | 5,000 | 4 | 5,004 |
| Paravant Inc. | 11/27/02 | 92,925 | 102 | 93,027 |
| Current year business combinations | | 190,875 | 2,560 | 193,435 |
| Spar Aerospace Ltd. working capital adjustment(A) | | 2,977 | | 2,977 |
| Total payments pursuant to business combinations | | \$ 193,852 | \$ 2,560 | \$ 196,412 |

(A) Represents working capital payment made to SPAR in December, 2002. See Part I, Item 3 of our March 31, 2002, 10-K.

The following table summarizes the sales of our businesses:

| Divestitures | Date of Transaction | Cash Received |
|--------------|---------------------|---------------|
|--------------|---------------------|---------------|

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| | | | |
|--------------------------------------|----------|----|-------|
| DRS Ahead Technology | 5/27/02 | \$ | 60(B) |
| DRS Advanced Programs, Inc. | 11/22/02 | | 7,624 |
| Proceeds from the sale of businesses | | \$ | 7,684 |

(B) We sold DRS Ahead Technology for \$3.1 million and received a \$3.1 million interest bearing promissory note as consideration. The promissory note is payable over an 80-month term. This amount represents the scheduled payments on the note which have been received through December 31, 2002.

Our long-term growth strategy includes a disciplined program of acquiring companies that are both strategic and expected to be accretive to our earnings. Continuation of our acquisition program will depend, in part, on the availability of financial resources at interest rates and costs of capital that are acceptable to us. We would expect to utilize cash generated by operations, as well as cash available under our Credit Facility, which also may include the renegotiation of our credit limit to finance such acquisitions. Other sources of capital could include proceeds from a sale of our common stock and the placement of convertible or high-yield debt. We continually evaluate the capital markets climate and may access such markets when the circumstances appear favorable to us. We believe that sufficient capital resources will be available to us from one or several of these sources to finance future acquisitions that we believe to be strategic and accretive to our net earnings. However, no assurances can be provided that such financing will be available and at a cost that is acceptable to us or that we will identify acceptable acquisition candidates.

Financing Activities For the fiscal period ended December 31, 2002, financing activities provided \$205.8 million. Sources of cash included our December 20, 2002 issuance of approximately 5.5 million shares of common stock, including shares related to an over-allotment option that was granted to the underwriters, at \$28.00 per share, resulting in net proceeds of approximately \$145.3 million after underwriting discounts, and \$75.0 million in new term loans drawn down from our amended and restated credit agreement. Uses of cash included the retirement of \$12.0 in term debt acquired in the Paravant merger and \$1.3 million in scheduled payments on our long-term debt, primarily related to our term loans. We also borrowed and repaid \$6.5 million under our senior secured revolving line of credit.

In connection with the Paravant merger, on November 27, 2002, we entered into a \$338.6 million amended and restated credit agreement (the Credit Facility). Wachovia Bank, National Association is the Administrative Agent under the amended and restated credit agreement. The amended Credit Facility consists of a \$125 million senior secured revolving line of credit and a \$213.6 million senior secured term loan facility. The maturity dates of the term loan and the revolving credit facility are September 30, 2008 and September 30, 2006, respectively. The term loan requires quarterly principal payments, which began with a \$537,500 payment on December 31, 2002. The Credit Facility is secured by a lien on substantially all of our assets. Borrowings under this Credit Facility bear interest, at our option, at either: a "base rate", as defined in the Credit Facility, equal to the higher of 0.50% per annum above the latest prime rate and federal funds rate plus a spread ranging from 1.25% to 2.25% per annum, depending on our total leverage ratio (TLR) at the time of determination; or a LIBOR rate, as defined in the Credit Facility, plus a spread ranging from 2.25% to 3.25% per annum, depending on our TLR. The TLR is defined as total debt minus performance-based letters of credit, as compared with EBITDA, as defined in the credit agreement.

As of December 31, 2002, \$213.1 million of term loans were outstanding against the Credit Facility, with a weighted average interest rate of approximately 4.7%. In addition to the term loans, \$19.7 million was contingently payable under outstanding letters of credit. The Company enters into standby letter-of-credit agreements with financial institutions and customers primarily relating to the guarantee of future performance on certain contracts to provide products and services and to secure advanced payments it has received from customers. There were no borrowings under the Company's revolving line of credit as of December 31, 2002.

We previously had a \$240 million credit agreement with a syndicate of lenders, with Wachovia Bank, National Association as the Administrative Agent, consisting of a term loan in the aggregate principal amount of \$140 million and a \$100 million revolving line of credit. Repayment terms and interest rates under the previous facility were substantially the same as those pursuant to the amended and restated credit agreement described above.

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There are certain covenants and restrictions placed on us under our Credit Facility, including a maximum TLR and a minimum fixed-charge ratio, a maximum amount of capital expenditures, a restriction on the payment of dividends on our capital stock, a limitation on the issuance of additional debt, a requirement that we offer to make prepayments on our term loans outstanding, with 50% of the aggregate net cash proceeds from any equity offering if our adjusted leverage ratio exceeds 2.00 to 1.00, and certain other restrictions. We were in compliance with all covenants under our Credit Facility at December 31, 2002. As of December 31, 2002, we had approximately \$105.3 million of additional available credit, after satisfaction of our borrowing base requirement.

We use "free cash flow" as a measure to evaluate our performance. The calculation of free cash flow is net cash provided by operating activities less capital expenditures. Free cash flow was \$12.2 million for the nine-month period ended December 31, 2002 and \$2.9 million for the corresponding period in the prior year.

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Contractual Obligations

Our contractual obligations and commitments principally include obligations associated with our outstanding indebtedness and future minimum operating lease obligations, as set forth in the table below:

Payments Due by Period

| | Total | Within 1 Year | 1-3 Years | 4-5 Years | After 5 Years |
|--------------------------------------|-------------------|------------------|------------------|------------------|-------------------|
| (in thousands) | | | | | |
| Long-term debt obligations | \$ 224,970 | \$ 7,625 | \$ 7,781 | \$ 54,822 | \$ 154,742 |
| Operating lease commitments | 74,235 | 14,173 | 22,927 | 17,167 | 19,968 |
| Total contractual obligations | \$ 299,205 | \$ 21,798 | \$ 30,708 | \$ 71,989 | \$ 174,710 |

We enter into standby letter-of-credit agreements with financial institutions and customers primarily relating to the guarantee of future performance on certain contracts to provide products and services and to secure advance payments we have received from customers. At December 31, 2002, we had contingent liabilities on outstanding letters of credit as follows:

Contingent Payments Due by Period

| | Total | Within 1 Year | 1-3 Years | After 3 Years |
|---------------------------|-----------|------------------|--------------|------------------|
| (in thousands) | | | | |
| Standby letters of credit | \$ 19,720 | \$ 7,246 | \$ 12,274 | \$ 200 |

Cash and cash equivalents, internally generated cash flow from operations and other available financing resources are expected to be sufficient to meet anticipated operating, capital expenditure and debt service requirements during the next twelve months and the foreseeable future. Consistent with our desire to generate cash to invest in our core businesses and reduce debt, we anticipate that, subject to prevailing financial, market and economic conditions, we may divest certain non-core businesses. There can be no assurance, however, that our business will continue to generate cash flow at current levels, or that anticipated operational improvements will be achieved. If we are unable to generate sufficient cash flow from operations to service our debt, we may be required to sell assets, reduce capital expenditures, refinance all or a portion of our existing debt or obtain additional financing. Our ability to make scheduled principal payments or pay interest on or refinance our indebtedness depends on our future performance and financial results, which, to a certain extent, are subject to general conditions in or affecting the defense industry and to general economic, political, financial, competitive, legislative and regulatory factors beyond our control.

Backlog

Backlog represents products or services that our customers have committed by contract to purchase from us. Our backlog at December 31, 2002 was \$844.0 million. The backlog at March 31, 2002 was \$595.3 million. We booked approximately \$503.9 million in new orders in the

first nine months of fiscal 2003.

Our backlog is subject to fluctuations and is not necessarily indicative of future sales. Moreover, cancellations of purchase orders or reductions of product quantities in existing contracts could substantially and materially reduce our backlog and, consequently, future revenues. Our failure to replace canceled or reduced backlog would have an adverse impact on future revenues.

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Recently Issued Accounting Pronouncements

In December 2002, the Financial Accounting Standards Board issued Statement No. 148, "Accounting for Stock-Based Compensation Transition disclosure, An Amendment of FASB Statement No. 123" (SFAS 148). This statement provides alternative methods of transition for a voluntary change to the fair value-based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of Statement No. 123 to require more prominent and more frequent disclosures in financial statements about the effects of stock-based compensation. The provisions of SFAS 148 are effective for fiscal years ending after December 15, 2002 and the interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. We will adopt the disclosure provisions of SFAS 148 for our fiscal year ending March 31, 2003. The adoption of SFAS 148 will not have an impact on our results of operations or financial position as we do not plan to change our method of accounting for stock-based compensation.

In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" (SFAS 146). SFAS 146 requires Companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Previous accounting guidance was provided by EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)" (EITF 94-3). SFAS 146 replaces EITF 94-3. The Statement is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. We are currently evaluating the provisions of the Statement.

In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations" (SFAS 143). SFAS 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The purpose of SFAS No. 143 is to develop consistent accounting of asset retirement obligations and related costs in the financial statements and to provide more information about future cash outflows, leverage, and liquidity regarding retirement obligations and the gross investment in long-lived assets. SFAS No. 143 is effective for financial statements issued for fiscal years beginning after June 15, 2002. We are in the process of evaluating SFAS 143 but we do not anticipate that the adoption of the statement will have a material effect on our results of operations or financial position.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

See Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk", of our Annual Report on Form 10-K for the fiscal year ended March 31, 2002 for a discussion of our exposure to market risks. There was no significant change in those risks during the nine months ended December 31, 2002, except for interest rate risk.

We currently have a \$338.6 million amended and restated credit agreement. The amended credit facility consists of a \$125 million senior secured revolving line of credit and a \$213.6 million senior secured term loan facility. The maturity dates of the term loan and the revolving credit facility are September 30, 2008 and September 30, 2006, respectively. Borrowings under the Credit Facility bear interest based on LIBOR (London Interbank Offered Rate), United States Prime Rate or United States Federal Funds Rate. Therefore, we are exposed to interest rate risk on our variable rate borrowings. Although there were no borrowings outstanding under our line of credit as of December 31, 2002, we had \$213.1 million outstanding under our Term Loan. Excluding the notional amounts covered under our interest rate collar agreements, a 12.5 basis point increase/decrease in interest rates would have resulted in an increase/decrease in interest expense of \$0.1 million and \$0.2 million, respectively, for the three- and nine-month periods ended December 31, 2002.

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Item 4. Controls and Procedures

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Evaluation of Disclosure Controls and Procedures. The Company's Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"). Based on such evaluation, such officers have concluded that, as of the Evaluation Date, the Company's disclosure controls and procedures are effective in alerting them on a timely basis to material information relating to the Company (including its consolidated subsidiaries) and required to be included in the Company's reports filed or submitted under the Exchange Act.

Changes in Internal Controls. Since the Evaluation Date, there have not been any significant changes in the Company's internal controls or in other factors that could significantly affect such controls.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We are party to various legal actions and claims arising in the ordinary course of our business. In our opinion, we have adequate legal defenses for each of the actions and claims, and we believe that their ultimate disposition will not have a material adverse effect on our consolidated financial position, results of operations or liquidity.

We recently settled a dispute with Spar Aerospace Ltd. with respect to the working capital adjustment provided for in the purchase agreement between us and Spar dated as of September 19, 1997, pursuant to which we acquired, through certain of our subsidiaries, certain assets of Spar. Under the terms of this settlement, we agreed to pay Spar a working capital adjustment of CAN\$4,616,000 (or approximately \$3,000,000) and CAN\$723,654 (or approximately \$460,000) in interest. During fiscal 2002, we accrued \$3.9 million, including interest, associated with the dispute. In connection with this settlement, the parties agreed to release each other from all claims arising out of or relating to the working capital adjustment provision in the purchase agreement and to discontinue all legal actions relating thereto.

On October 3, 2001, a lawsuit was filed in the United States District Court of the Eastern District of New York by Miltope Corporation, a corporation of the State of Alabama, and IV Phoenix Group, Inc., a corporation of the State of New York, against DRS Technologies, Inc., DRS Electronic Systems, Inc. and a number of individual defendants, several of whom are employed by DRS Electronic Systems, Inc. The plaintiffs allege claims against us of infringement of a number of patents, breach of a confidentiality agreement, misappropriation of trade secrets, unjust enrichment and unfair competition. The claims relate generally to the activities of certain former employees of IV Phoenix Group and the hiring of some of those employees by us. The plaintiffs seek damages of not less than \$5.0 million for each of the claims. The plaintiffs also allege claims for tortious interference with business relationships, tortious interference with contracts and conspiracy to breach fiduciary duty. The plaintiffs seek damages of not less than \$47.1 million for each claim. In addition, plaintiffs seek punitive and treble damages, injunctive relief and attorney's fees. In our answer, we have denied the plaintiffs' allegations and we intend to vigorously defend this action. In February 2002, plaintiffs filed an amended complaint, which eliminated the patent infringement claims and added claims related to statutory and common law trademark infringement. Although this action is still in discovery, we believe we have meritorious defenses and do not believe the action will have a material adverse effect on our earnings or financial condition.

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Item 6. Exhibits and Reports on Form 8-K

(a)
Exhibits

| <u>Exhibit No.</u> | <u>Description</u> |
|------------------------|--------------------|
|------------------------|--------------------|

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| Exhibit No. | Description |
|--------------------|---|
| 99.1 | Certification of CEO Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 99.2 | Certification of CFO Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

(b)

Reports on Form 8-K

The following report on form 8-K was filed during the quarter ended December 31, 2002:

1. Form 8-K filed on December 2, 2002, in connection with DRS Technologies, Inc.'s acquisition of Paravant Inc.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DRS TECHNOLOGIES, INC.
Registrant

Date: February 14, 2003

By: /s/ RICHARD A. SCHNEIDER

Richard A. Schneider
Executive Vice President and Chief Financial Officer

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Chief Executive Officer Certification

I, Mark S. Newman, Chief Executive Officer of DRS Technologies, Inc. (the "registrant") certify that:

1. I have reviewed this quarterly report on Form 10-Q of DRS Technologies, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
- 4.

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The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

- a) Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
- b) Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
- c) Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5.

The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

- a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
- b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6.

The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: February 14, 2003

/s/ MARK S. NEWMAN

Mark S. Newman
Chief Executive Officer

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Chief Financial Officer Certification

I, Richard A. Schneider, Chief Financial Officer of DRS Technologies, Inc. (the "registrant") certify that:

1. I have reviewed this quarterly report on Form 10-Q of DRS Technologies, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with

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respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: February 14, 2003

/s/ RICHARD A. SCHNEIDER

Richard A. Schneider
Chief Financial Officer

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