DRS TECHNOLOGIES INC
Form 10-Q
August 08, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the quarterly period ended June 30, 2005
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.

(Exact name of registrant as specified in its charter)

Delaware	**13-2632319**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

5 Sylvan Way, Parsippany, New Jersey 07054
(Address of principal executive offices)

(973) 898-1500
(Registrant s telephone number, including area code)

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 x No o

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes x No o

As of August 4, 2005, 27,893,503 shares of DRS Technologies, Inc. $0.01 par value common stock were outstanding.

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Index to Quarterly Report on Form 10-Q
For the Quarter Ended June 30, 2005

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

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

	June 30, 2005	March 31, 2005
Assets		
Current assets		
Cash and cash equivalents	$ 223,652	$ 306,852
Accounts receivable, net of allowances for doubtful accounts of $2,933 and $2,659 as of June 30, 2005 and March 31, 2005, respectively	244,685	237,912
Inventories, net	221,447	208,141
Prepaid expenses, deferred income taxes and other current assets	48,798	42,134
Total current assets	738,582	795,039
Property, plant and equipment, less accumulated depreciation of $109,189 and $101,335 at June 30, 2005 and March 31, 2005, respectively	142,137	143,264
Acquired intangible assets, net	105,478	100,030
Goodwill	851,536	815,407
Other noncurrent assets	32,281	32,901
Total assets	$ 1,870,014	$ 1,886,641
Liabilities and Stockholders Equity		
Current liabilities		
Current installments of long-term debt	$ 2,606	$ 2,652
Accounts payable	123,542	111,222
Accrued expenses and other current liabilities	259,684	301,361
Total current liabilities	385,832	415,235
Long-term debt, excluding current installments	716,698	727,611
Other liabilities	76,620	72,367
Total liabilities	1,179,150	1,215,213
Commitments and contingencies (Notes 2, 7 and 14)		
Stockholders equity		
Preferred stock, no par value. Authorized 2,000,000 shares; none issued at June 30, 2005 and March 31, 2005		
Common Stock, $.01 par value per share. Authorized 50,000,000 shares; issued 27,729,694 and 27,472,495 shares at June 30, 2005 and March 31, 2005, respectively	277	275
Additional paid-in capital	474,310	467,027
Retained earnings	213,113	199,924
Accumulated other comprehensive earnings	4,840	6,198
Unamortized stock compensation	(1,676)	(1,996)
Total stockholders equity	690,864	671,428
Total liabilities and stockholders equity	$ 1,870,014	$ 1,886,641

See accompanying Notes to the Consolidated Financial Statements.

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

	Three Months Ended June 30, 2005	2004
Revenues	$ 338,459	$ 291,151
Costs and expenses	303,401	262,651
Operating income	35,058	28,500
Interest income	1,877	129
Interest and related expenses	12,211	8,994
Other income (expense), net	25	(60)
Earnings from continuing operations before minority interest and income taxes	24,749	19,575
Minority interest	580	397
Earnings from continuing operations before income taxes	24,169	19,178
Income taxes	10,151	8,207
Earnings from continuing operations	14,018	10,971
Earnings from discontinued operations, net of income taxes		800
Net earnings	$ 14,018	$ 11,771
Net earnings per share of common stock:		
Basic earnings per share:		
Earnings from continuing operations	$ 0.51	$ 0.41
Earnings from discontinued operations, net of income taxes	$	$ 0.03
Net earnings	$ 0.51	$ 0.44
Diluted earnings per share:		
Earnings from continuing operations	$ 0.49	$ 0.40
Earnings from discontinued operations, net of income taxes	$	$ 0.03
Net earnings	$ 0.49	$ 0.43
Dividends per common share	$ 0.03	$

See accompanying Notes to the Consolidated Financial Statements.

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

	Three Months Ended June 30, 2005	2004
Cash Flows from Operating Activities		
Earnings from continuing operations	$ 14,018	$ 10,971
Adjustments to reconcile earnings from continuing operations		
to cash flows from operating activities of continuing operations:		
Depreciation and amortization	10,417	9,920
Stock-based compensation	245	330
Deferred income taxes	(522)	(915)
Inventory reserve and provision for doubtful accounts	946	551
Amortization and write-offs of deferred financing fees	952	915
Other, net	77	354
Changes in assets and liabilities, net of effects from business combinations:		
(Increase) decrease in accounts receivable	(2,453)	29,014
(Increase) decrease in inventories	(7,991)	6,956
Increase in prepaid expenses and other current assets	(4,102)	(463)
Increase (decrease) in accounts payable	10,450	(5,645)
Decrease in accrued expenses and other current liabilities	(30,320)	(22,237)
Decrease in customer advances	(7,207)	(8,485)
Other, net	944	(600)
Net cash (used in) provided by operating activities of continuing operations	(14,546)	20,666
Net cash provided by operating activities of discontinued operations		4,210
Net cash (used in) provided by operating activities	(14,546)	24,876
Cash Flows from Investing Activities		
Capital expenditures	(6,336)	(7,411)
Payments pursuant to business combinations, net of cash acquired	(52,350)	
Other, net	(206)	679
Net cash used in investing activities of continuing operations	(58,892)	(6,732)
Net cash used in investing activities of discontinued operations		(207)
Net cash used in investing activities	(58,892)	(6,939)
Cash Flows from Financing Activities		
Net borrowings of short-term debt		389
Return of advanced interest on senior subordinated notes	(1,986)	
Debt issuance costs	(120)	
Repayment of long-term debt	(10,674)	(10,762)
Proceeds from stock option exercises	4,175	241
Dividends paid	(829)	
Net cash used in financing activities of continuing operations	(9,434)	(10,132)
Net cash used in financing activities of discontinued operations		(8)
Net cash used in financing activities	(9,434)	(10,140)
Effect of exchange rates on cash and cash equivalents	(328)	(366)
Net (decrease) increase in cash and cash equivalents	(83,200)	7,431
Cash and cash equivalents, beginning of period	306,852	56,790
Cash and cash equivalents, end of period	$ 223,652	$ 64,221

See accompanying Notes to the Consolidated Financial Statements

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES
Notes to the Consolidated Financial Statements
(Unaudited)

1. Basis of Presentation

The accompanying unaudited Consolidated Financial Statements of DRS Technologies, Inc., its wholly-owned subsidiaries and a partnership of which DRS owns an 80% controlling interest (hereinafter, 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. In the opinion of the Company, the interim consolidated 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 June 30, 2005, the results of its operations for the three-month periods ended June 30, 2005 and 2004, and its cash flows for the three-month periods ended June 30, 2005 and 2004. The results of operations for the three-month period ended June 30, 2005 are not necessarily indicative of the results to be expected for the full year. Certain fiscal 2005 amounts have been reclassified to conform to the fiscal 2006 presentation. 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, 2005, included in the Company s filing on Form 10-K, for the year ended March 31, 2005.

On March 10, 2005 the Company completed the sale of two of its operating units DRS Weather Systems, Inc. (DRS Weather) and DRS Broadcast Technology (DRS Broadcast). The operating units were acquired in connection with the Company s fiscal 2004 acquisition of Integrated Defense Technologies, Inc. (IDT). As a result of the divestiture, DRS Weather s and DRS Broadcast s results of operations for the three months ended June 30, 2004 are included in the Consolidated Statements of Earnings as Earnings from discontinued operations. The cash flows of the discontinued operations also are presented separately in the Consolidated Statements of Cash Flows for the three months ended June 30, 2004. All corresponding footnotes reflect the discontinued operations presentation.

2. Acquisitions and Divestitures

Acquisitions

On April 15, 2005, DRS acquired Codem Systems, Inc. (Codem) in a stock purchase transaction for approximately $31.6 million in cash (subject to a working capital adjustment), with additional consideration payable of up to $5.0 million upon achievement of certain annual bookings targets for a period of three years. In addition to the purchase price the Company recorded approximately $0.4 million for acquisition-related costs. The results of Codem s operations have been included in the Company s financial statements since the date of acquisition.

Codem is located in Merrimack, New Hampshire, and is a provider of signals intelligence (SIGINT) systems, network interface modules, and high-performance antenna control systems. As a supplier of SIGINT products, Codem focuses on solutions for communications and surveillance applications supporting the intelligence, military and homeland security markets. Management believes that the addition of Codem will further enhance DRS s existing intelligence product base. Codem is being managed as a part of the Company s Command, Control, Communications, Computers and Intelligence (C4I) Group.

The Company is in the process of reviewing the third-party valuation of certain acquired assets (including acquired intangible assets), as well as performing its own internal assessment of certain other

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DRS TECHNOLOGIES, INC. AND SUBSIDIARIES
Notes to the Consolidated Financial Statements (Continued)
(Unaudited)

acquired assets and liabilities; thus the preliminary allocation of the purchase price may change. Based on preliminary purchase price allocations, the Company has estimated goodwill to be $24.8 million, which has been allocated to the C4I Group, and acquired intangible assets to be $7.5 million. Acquired intangible assets of $1.9 million and $5.6 million were allocated to technology-based and customer-related intangibles, respectively, which are both being amortized over periods of 10 years. The Company expects to complete its purchase price allocation in the third quarter of fiscal 2006.

On June 27, 2005, DRS acquired WalkAbout Computer Systems (WalkAbout) in a stock purchase transaction for approximately $13.8 million in cash (subject to a working capital adjustment), with additional consideration payable of up to $5.0 million upon achievement of certain revenue targets for a period of two and a half years. In addition to the purchase price the Company recorded approximately $0.3 million for acquisition-related costs. The results of WalkAbout have been included in the Company s financial statements since the date of acquisition.

WalkAbout is located in West Palm Beach, Florida and is a manufacturer of several lines of rugged, mobile tablet PCs, serving industrial, municipal, military and government markets. Management believes that the acquisition of WalkAbout will enhance DRS s position in the tactical computer systems business by broadening its product offerings. WalkAbout is being managed as part of the Company s C4I Group.

The Company is in the process of obtaining a third-party valuation of certain assets (including acquired intangible assets), as well as performing its own internal assessment of certain other acquired assets and liabilities; thus the preliminary allocation of the purchase price will change, and such change could be significant. Based on preliminary purchase price allocations, the Company has estimated goodwill to be $12.0 million and has allocated the goodwill to the C4I Group. No amounts have been allocated to acquired intangible assets pending receipt of the third-party valuation. The Company expects to complete its purchase price allocation in the third quarter of fiscal 2006.

During the three months ended June 30, 2005, the Company paid $6.7 million in consideration to satisfy an earn-out obligation on its acquisition of DKD, Inc. (now operating as a component of Infrared Technologies L.P.). The earn-out was recorded as an increase to goodwill during the fourth quarter of fiscal 2005.

Divestitures

On March 10, 2005, the Company completed the sale of DRS Weather and DRS Broadcast. A summary of the results of discontinued operations for the three months ended June 30, 2004 follows:

	(in thousands)
Revenues	$ 9,578
Earnings before taxes	$ 1,293
Income tax expense	493
Earnings from discontinued operations	$ 800

3. Stock-Based Compensation

The Company has one stock-based compensation plan, the 1996 Omnibus Plan (Omnibus Plan). Under the terms of the Omnibus Plan, stock options and restricted stock may be granted to key employees,

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DRS TECHNOLOGIES, INC. AND SUBSIDIARIES
Notes to the Consolidated Financial Statements (Continued)
(Unaudited)

directors and consultants of the Company. The Company accounts for stock options granted to employees and directors under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees and related interpretations. Compensation expense for stock options granted to an employee or director is recognized in earnings based on the excess, if any, of the quoted market price of DRS common stock at the date of the grant, or other measurement date, over the amount an employee or director must pay to acquire the common stock. When the exercise price of the option granted to an employee or director equals or exceeds the quoted market price of DRS common stock at the date of grant, the Company does not recognize compensation expense. Compensation cost for restricted stock is recorded based on the quoted market price of DRS common stock on the date of grant.

The Company elected not to adopt the fair-value-based method of accounting for stock-based employee compensation, as permitted by Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure an amendment of SFAS No. 123. Had the Company adopted the fair-value-based method provisions of SFAS No. 123, it would have recorded a non-cash expense for the estimated fair value of the stock options that the Company had granted to its employees and directors.

The table below compares the as reported net earnings and earnings per share to the pro forma net earnings and earnings per share that the Company would have reported if it had elected to recognize compensation expense in accordance with the fair value-based method of accounting of SFAS No. 123. For purposes of determining the pro forma effects of SFAS No. 123, the estimated fair value of options granted was calculated using the Black-Scholes option pricing valuation model.

	Three Months Ended June 30, 2005	2004
	(in thousands, except per-share data)	
Net earnings, as reported	$ 14,018	$ 11,771
Add: Stock-based compensation expense included in reported net earnings, net of taxes	148	196
Less: Total stock-based compensation expense determined under fair-value-based method for all awards, net of taxes	(1,427)	(1,272)
Pro forma net earnings	$ 12,739	$ 10,695
Earnings per share:		
Basic as reported	$ 0.51	$ 0.44
Basic pro forma	$ 0.46	$ 0.40
Diluted as reported	$ 0.49	$ 0.43
Diluted pro forma	$ 0.45	$ 0.39

In December 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment (SFAS No. 123R), which replaces SFAS No. 123 and supercedes APB Opinion No. 25. SFAS No. 123R addresses the accounting for transactions in which an enterprise receives employee services in exchange for (a) equity

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES
Notes to the Consolidated Financial Statements (Continued)
(Unaudited)

instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise s equity instruments or that may be settled by the issuance of such equity instruments. SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options and restrictive stock grants and units, to be recognized as a compensation cost based on their fair values. The pro forma disclosures previously permitted under SFAS No. 123 no longer will be an alternative to financial statement recognition. Under SFAS No. 123R, the Company must determine the appropriate fair value model to be used for valuing share-based payments, the amortization method for compensation cost and the transition method to be used at date of adoption. The transition methods include prospective and retroactive adoption options. Under the retroactive option, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. The prospective method requires that compensation expense be recorded for all unvested stock options and restricted stock at the beginning of the first quarter of adoption of SFAS No. 123R, while the retroactive methods would record compensation expense for all unvested stock options and restricted stock beginning with the first period restated. The Company is evaluating the requirements of SFAS No. 123R and expects that the adoption of SFAS No. 123R will have a material impact on the Company s consolidated results of operations and earnings per share. The Company has not yet determined the method of adoption or the effect of adopting SFAS No. 123R, and it has not determined whether the adoption will result in amounts that are similar to the current pro forma disclosures under SFAS No. 123 included above.

On April 15, 2005, the SEC issued Release No. 33-8568, Amendment to Rule 4-01a of regulation S-X regarding the compliance date for SFAS No. 123R, (Revised 2004). The SEC Release amends the effective date for compliance with SFAS 123R to the beginning of the first fiscal year following June 15, 2005, which is the fiscal year beginning on April 1, 2006 for DRS. On March 29, 2005, the SEC issued Staff Accounting Bulletin (SAB) No. 107, Share-Based Payment (SAB 107). SAB 107 provides guidance to assist registrants in the initial implementation of SFAS 123R. SAB 107 includes, but is not limited to, interpretive guidance related to share-based payment transactions with nonemployees, valuation methods and underlying expected volatility and expected term assumptions, the classification of compensation expenses and accounting for the income tax effects of share-based arrangements upon adopting the SFAS 123R. The Company currently is assessing the guidance provided in SAB 107 in connection with its implementation of SFAS 123R.

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES
Notes to the Consolidated Financial Statements (Continued)
(Unaudited)

4. Inventories

Inventories are summarized as follows:

	June 30, 2005 (in thousands)	March 31, 2005
Work-in-process	$ 252,589	$ 211,914
General and administrative costs	47,509	47,365
Raw material and finished goods	37,664	33,127
	337,762	292,406
Less: Progress payments and certain customer advances	108,634	75,541
Inventory reserve	7,681	8,724
Total	$ 221,447	$ 208,141

Inventoried contract costs for the Company s businesses that are primarily government contractors include certain general and administrative (G&A) costs, including internal research and development costs (IRAD) and bid and proposal costs (B&P). G&A, IRAD and B&P costs are allowable, indirect contract costs under U.S. Government regulations. The Company allocates these costs to government contracts and accounts for them as product costs at the majority of the Company s operating units, not as period expenses.

The table below presents a summary of G&A, IRAD and B&P costs included in inventoried contract costs and changes to them, including amounts used in the determination of costs and expenses.

The cost data in the table below does not include the G&A, IRAD and B&P costs for the Company s lines of businesses that are not primarily contracted with the U.S. government, which are expensed as incurred.

	Three Months Ended June 30, 2005 (in thousands)	2004
Balance in inventory at March 31,	$ 47,365	$ 37,854
Add: Incurred costs	53,178	53,809
Less: Amounts included in costs of sales	(53,034)	(51,582)
Balance in inventory at June 30,	$ 47,509	$ 40,081

Total expenditures for IRAD amounted to approximately $9.2 million and $8.3 million for the three-month periods ended June 30, 2005 and 2004, respectively.

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES
Notes to the Consolidated Financial Statements (Continued)
(Unaudited)

5. Goodwill and Intangible Assets

The following disclosure presents certain information regarding the Company s acquired intangible assets as of June 30, 2005 and March 31, 2005. 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 (in thousands)	Gross Carrying Amount	Accumulated Amortization	Net Balance
As of June 30, 2005				
Technology-based intangibles	19 years	$ 47,861	$ (11,881)	$ 35,980
Customer-related intangibles	17 years	81,190	(11,692)	69,498
Total		$ 129,051	$ (23,573)	105,478
As of March 31, 2005				
Technology-based intangibles	19 years	$ 45,961	$ (11,172)	$ 34,789
Customer-related intangibles	17 years	75,590	(10,349)	65,241
Total		$ 121,551	$ (21,521)	100,030

The aggregate acquired intangible asset amortization expense for the three-month periods ended June 30, 2005 and 2004 was $2.1 million and $1.7 million, respectively. The estimated acquired intangible amortization expense, based on gross carrying amounts at June 30, 2005, is estimated to be $8.5 million per year for fiscal 2006 through fiscal 2009 and $8.3 million for fiscal 2010.

The table below reconciles the change in the carrying amount of goodwill by operating segment for the period from March 31, 2005 to June 30, 2005.

	C4I Group (in thousands)	SR Group	Total
Balance as of March 31, 2005	$ 447,631	$ 367,776	$ 815,407
Codem acquisition	24,820		24,820
WalkAbout acquisition	11,972		11,972
Foreign currency translation adjustment	(663)		(663)
Balance as of June 30, 2005	$ 483,760	$ 367,776	$ 851,536

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES
Notes to the Consolidated Financial Statements (Continued)
(Unaudited)

6. Product Warranties

Product warranty costs are accrued when the covered products are delivered to the customer. Product warranty expense is recognized based on the terms of the product warranty and the related estimated costs, considering historical claims expense. Accrued warranty costs are reduced as these costs are incurred and as the warranty period expires and may be otherwise modified as specific product performance issues are identified and resolved. The table below presents the changes in the Company s accrual for product warranties for the three months ended June 30, 2005 and 2004, which are included in accrued expenses and other current liabilities.

	Three Months Ended June 30, 2005 (in thousands)	2004
Balance at March 31,	$ 21,839	$ 23,279
Acquisitions during the period	2,661	
Accruals for product warranties issued during the period	1,665	2,459
Settlements made during the period	(2,942)	(2,901)
Other	(27)	1,614
Balance at June 30,	$ 23,196	$ 24,451

7. Debt

	June 30, 2005 (in thousands)	March 31, 2005
Senior subordinated notes, including bond premium of $9,434 and $9,716 at June 30, 2005 and March 31, 2005, respectively	$ 559,434	$ 559,716
Term loan	156,870	167,460
Other obligations	3,000	3,087
	719,304	730,263
Less:		
Current installments of long-term debt	2,606	2,652
Total long-term debt	$ 716,698	$ 727,611

On October 30, 2003, the Company issued $350.0 million aggregate principal amount of 6⅞% Senior Subordinated Notes, due November 1, 2013 (the Notes). The Notes were issued under an indenture with The Bank of New York (the Indenture). Subject to a number of exceptions, the Indenture restricts the Company s ability and the ability of its subsidiaries to incur more debt, make certain investments, repurchase stock, create liens, enter into transactions with affiliates, enter into sale lease-back transactions, merge or consolidate, and transfer or sell assets. The Notes are unconditionally guaranteed, jointly and severally, by DRS s current and future wholly-owned domestic subsidiaries. The foreign subsidiaries and certain domestic subsidiaries of DRS do not guarantee the Notes. See Note 15, Guarantor and Non-guarantor Financial Statements for additional disclosures.

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES
Notes to the Consolidated Financial Statements (Continued)
(Unaudited)

On December 23, 2004, the Company issued an additional $200.0 million aggregate principal amount of 6⅞% Senior Subordinated Notes due November, 2013. The notes were offered as additional debt securities under the Indenture with identical terms and same guarantors as the existing Notes. The new notes were priced at 105% of the principal amount, reflecting an effective interest rate of approximately 6.13%. The net proceeds of the offering were approximately $208.3 million (including $2.0 million of advanced interest on the new notes that had accrued from November 1, 2004 to December 23, 2004), after deducting $3.7 million in commissions and other costs related to the debt issuance. On May 1, 2005, the advanced interest of $2.0 million was repaid in conjunction with the semi-annual interest payments on the Notes.

The book value and fair value of the senior subordinated debt at June 30, 2005 was approximately $559.4 million and $569.3 million, respectively.

The Company has a $411.0 million credit facility (the Credit Facility), consisting of a $175.0 million senior secured revolving line of credit and a $236.0 million senior secured term loan, and have the ability to borrow up to two additional term loans totaling $100.0 million at any time prior to maturity. As of June 30, 2005 and March 31, 2005, the Company had $156.9 million and $167.5 million, respectively, of term loans outstanding against the Credit Facility. The Credit Facility is guaranteed by substantially all of DRS s domestic subsidiaries. In addition, it is collateralized by liens on substantially all of the assets of the Company s subsidiary guarantors and certain of DRS s other subsidiaries assets and by a pledge of certain of the Company s non-guarantor subsidiaries capital stock. The term loan and the revolving credit facility will mature in November 2010 and November 2008, respectively. The weighted average interest rate on the Company s term loans was 5.1% as of June 30, 2005 (4.4% as of March 31, 2005), excluding the impact of the amortization of debt issuance costs. As of June 30, 2005, the Company had $142.3 million available under its revolving line of credit. There were no borrowings under the Company s revolving line of credit as of June 30, 2005 and March 31, 2005.

During the three months ended June 30, 2005, the Company repaid $10.0 million of its term loan, at its discretion, and recorded a $0.2 million charge to interest and related expenses for the related write-off of a portion of the debt issuance costs. On July 29, 2005 the Company prepaid an additional $10.0 million of its term loan at its discretion and recorded a $0.2 million charge to interest and related expenses.

From time to time, the Company enters into standby letter-of-credit and bank guarantee agreements with financial institutions and customers, primarily relating to the guarantee of its future performance on certain contracts to provide products and services and to secure advance payments it has received from its customers. As of June 30, 2005, $37.4 million was contingently payable under letters of credit and bank guarantees. Approximately $3.8 million and $0.9 million in letters of credit and bank guarantees as of June 30, 2005 were issued outside of the Credit Facility and by a bank agreement for the Company s U.K. subsidiary, respectively, and are not considered when determining the availability under the Company s revolving line of credit.

The Company has a mortgage note payable that is secured by a lien on its facility located in Palm Bay, Florida, and bears interest at a rate equal to the one-month LIBOR plus 1.65%. In the third quarter of fiscal 2005, the Company terminated an interest rate swap relating to the mortgage that qualified for hedge accounting. The balance of the mortgage as of June 30, 2005 and March 31, 2005 was $2.9 million and $3.0 million, respectively. Monthly payments of principal and interest totaling approximately $34 thousand will continue through December 1, 2016.

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES
Notes to the Consolidated Financial Statements (Continued)
(Unaudited)

During fiscal 2005, the Company had two interest rate swap agreements, each in the amount of $25.0 million, with Wachovia Bank, N.A. and Bank of America Corporation (the Banks), both of which had expiration dates of September 30, 2008. These swap agreements were accounted for as cash flow hedges, and as such, changes in the fair values of the swap agreements were recorded as adjustments to accumulated other comprehensive earnings. On January 18, 2005, the Company terminated the two swap agreements. As a result of the termination, the Company received $1.8 million in cash and the related unrealized gain in other comprehensive income, net of taxes, is being credited to interest expense over the remaining life of the Company s term loan.

8. Earnings per Share

Basic earnings per share (EPS) is computed by dividing net earnings by the weighted average number of shares of common stock outstanding during each period. The computation of diluted earnings per share includes the effect of shares from the assumed exercise of dilutive stock options, restricted stock and restricted stock units. The following table presents the components of basic and diluted earnings per share:

	Three Months Ended June 30,	
	2005	2004
	(in thousands, except per-share data)	
Basic EPS computation		
Earnings from continuing operations	$ 14,018	$ 10,971
Earnings from discontinued operations, net of income taxes		800
Net earnings	$ 14,018	$ 11,771
Weighted average common shares outstanding	27,479	26,936
Basic earnings per share		
Earnings from continuing operations	$ 0.51	$ 0.41
Earnings from discontinued operations, net of income taxes	$	$ 0.03
Net earnings	$ 0.51	$ 0.44
Diluted EPS computation		
Earnings from continuing operations	$ 14,018	$ 10,971
Earnings from discontinued operations, net of income taxes		800
Net earnings	$ 14,018	$ 11,771
Diluted common shares outstanding:		
Weighted average common shares outstanding	27,479	26,936
Stock options and restricted stock	922	537
Diluted common shares outstanding	28,401	27,473
Diluted earnings per share		
Earnings from continuing operations	$ 0.49	$ 0.40
Earnings from discontinued operations, net of income taxes	$	$ 0.03
Net earnings	$ 0.49	$ 0.43

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(Unaudited)

At June 30, 2005, all outstanding options are included in the diluted EPS calculation. At June 30 2004, there were 1,167,270 options outstanding that were excluded from the diluted EPS calculation because their inclusion would have had an antidilutive effect on EPS.

9. Comprehensive earnings

The components of comprehensive earnings for the three-month periods ended June 30, 2005 and 2004 consisted of the following:

	Three Months Ended June 30, 2005 (in thousands)	2004
Net earnings	$ 14,018	$ 11,771
Other comprehensive earnings:		
Foreign currency translation adjustments	(1,312)	(1,093)
Unrealized net gains on hedging instruments arising during the period, net of income tax		1,284
Amortization of unrealized gain on terminated hedging instruments, net of income taxes	(46)	
Comprehensive earnings	$ 12,660	$ 11,962

10. Pensions and Other Employee Benefits

The following table summarizes the components of net periodic benefit cost for the Company s pension and postretirement benefit plans for the three-month periods ended June 30, 2005 and 2004. These plans are more fully described in Note 12 to the Company s Consolidated Financial Statements for the year ended March 31, 2005.

	Funded Pension Plans		Postretirement Benefit Plans		Unfunded Supplemental Retirement Plans	
	Three Months Ended June 30,					
	2005 (in thousands)	2004	2005	2004	2005	2004
Service cost	$ 988	$ 961	$ 150	$ 134	$ 136	$ 104
Interest cost	1,511	1,455	241	238	279	241
Expected return on plan assets	(1,769)	(1,600)	(42)	(23)		
Amortization of unrecognized loss (gain)	43	32	(2)	23	42	1
Amortization of transition obligation			27	9		
Amortization of unrecognized prior-service cost	1	1			194	194
Net periodic benefit cost	$ 774					