

INTEGRATED DEFENSE TECHNOLOGIES INC  
Form 10-Q  
August 08, 2003

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 27, 2003 OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-31235

Integrated Defense Technologies, Inc.

-----  
(Exact name of registrant as specified in its charter)

Delaware

13-4027646

-----  
(State or other jurisdiction of  
incorporation or organization)

-----  
(I.R.S. Employer Identification No.)

110 Wynn Drive, Huntsville, Alabama

35805

-----  
(Address of principal executive offices)

-----  
(Zip Code)

(256) 895-2000

-----  
(Telephone Number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES  NO

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES  NO

Common stock, par value \$.01 per share: 21,327,931 shares  
outstanding as of August 8, 2003

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INTEGRATED DEFENSE TECHNOLOGIES, INC.  
FORM 10-Q  
June 27, 2003

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### PART I. FINANCIAL INFORMATION

#### ITEM 1.

#### INTEGRATED DEFENSE TECHNOLOGIES, INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS (Unaudited)

|   | June 27,<br>2003 | December 31,<br>2002 |
|---|------------------|----------------------|
| (In thousands except share and per share amounts) |                  |                      |
| ASSETS  |                  |                      |
| Current assets:                                   |                  |                      |
| Cash  | \$ 13,785        | \$ 8,969             |
| Restricted cash                                   | 448              | 1,140                |
| Accounts receivable, net                          | 133,687          | 134,304              |
| Inventories, net                                  | 21,996           | 20,242               |
| Prepaid expenses and other current assets         | 3,734            | 3,047                |
| Deferred income taxes                             | 6,544            | 6,456                |
| Total current assets                              | 180,194          | 174,158              |
| Property and equipment, net                       | 62,333           | 62,002               |
| Goodwill, net                                     | 142,124          | 143,809              |
| Other intangible assets, net (Note 5)             | 54,764           | 55,963               |

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|                       |           |           |
|-----------------------|-----------|-----------|
| Deferred income taxes | ---       | 2,987     |
| Other assets          | 7,443     | 8,781     |
| -----                 |           |           |
| Total Assets          | \$446,858 | \$447,700 |
| =====                 |           |           |

LIABILITIES AND STOCKHOLDERS' EQUITY

|   |         |          |
|---|---------|----------|
| Current liabilities:                      |         |          |
| Revolving credit loan                     | \$ ---  | \$ 2,500 |
| Current portion of long-term debt         | 7,302   | 7,348    |
| Accounts payable                          | 18,120  | 20,737   |
| Accrued compensation                      | 14,917  | 13,162   |
| Other accrued expenses                    | 16,145  | 13,230   |
| Derivative liabilities                    | 425     | 458      |
| Billings in excess of costs and earnings  | 9,099   | 6,055    |
| -----                                     |         |          |
| Total current liabilities                 | 66,008  | 63,490   |
| Long-term debt                            | 197,263 | 208,860  |
| Deferred income taxes                     | 918     | ---      |
| Pension and other postemployment benefits | 11,635  | 11,941   |
| -----                                     |         |          |
| Total liabilities                         | 275,824 | 284,291  |

Commitments and contingencies (Note 12)

|  |           |           |
|--|-----------|-----------|
| Stockholders' equity:  |           |           |
| Preferred stock, \$.01 par value per share,<br>20,000,000 shares authorized, none issued     |           |           |
| Common stock, \$.01 par value per share,<br>200,000,000 shares authorized, 21,327,931 issued | 213       | 213       |
| Additional paid-in capital   | 170,955   | 170,955   |
| Accumulated other comprehensive loss   | (5,844)   | (5,965)   |
| Retained earnings (deficit)  | 5,710     | (1,794)   |
| -----  |           |           |
| Total stockholders' equity   | 171,034   | 163,409   |
| -----  |           |           |
| Total Liabilities and Stockholders' Equity   | \$446,858 | \$447,700 |
| =====  |           |           |

The accompanying notes are an integral part of these consolidated financial statements.

INTEGRATED DEFENSE TECHNOLOGIES, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited)

|   | Quarter Ended    |                  | Six Months Ended |                  |
|---|------------------|------------------|------------------|------------------|
|   | June 27,<br>2003 | June 30,<br>2002 | June 27,<br>2003 | June 30,<br>2002 |
| -----                                   |                  |                  |                  |                  |
| (In thousands except per share amounts) |                  |                  |                  |                  |
| Revenue                                 | \$93,418         | \$72,099         | \$174,317        | \$140,492        |
| Cost of revenue                         | 63,982           | 50,288           | 119,092          | 99,131           |
| -----                                   |                  |                  |                  |                  |
| Gross profit                            | 29,436           | 21,811           | 55,225           | 41,361           |
| Sales and marketing expense             | 4,002            | 2,841            | 7,706            | 6,724            |

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|   |         |          |         |            |
|---|---------|----------|---------|------------|
| General and administrative expense                        | 8,130   | 6,411    | 16,255  | 11,931     |
| Research and development and bid<br>and proposal expenses | 6,685   | 4,493    | 12,254  | 8,068      |
| Amortization expense                                      | 756     | 201      | 1,536   | 418        |
| -----   |         |          |         |            |
| Income from operations                                    | 9,863   | 7,865    | 17,474  | 14,220     |
| Interest expense  | (3,001) | (1,027)  | (6,087) | (4,858)    |
| Refinancing costs   | ---     | ---      | ---     | (20,696)   |
| Other income (expense), net                               | 185     | 231      | 430     | 252        |
| -----   |         |          |         |            |
| Income (loss) before income taxes                         | 7,047   | 7,069    | 11,817  | (11,082)   |
| Income tax benefit (expense)                              | (2,572) | (2,579)  | (4,313) | 4,500      |
| -----   |         |          |         |            |
| Net income (loss)   | \$4,475 | \$ 4,490 | \$7,504 | \$ (6,582) |
| =====   |         |          |         |            |
| Earnings (loss) per share:                                |         |          |         |            |
| Basic   | \$.21   | \$.23    | \$.35   | \$ (.37)   |
| Diluted   | \$.21   | \$.21    | \$.35   | \$ (.37)   |
| =====   |         |          |         |            |
| Weighted-average shares outstanding:                      |         |          |         |            |
| Basic   | 21,328  | 19,801   | 21,328  | 17,837     |
| Diluted   | 21,328  | 21,328   | 21,328  | 17,837     |
| =====   |         |          |         |            |

The accompanying notes are an integral part of these consolidated financial statements.

INTEGRATED DEFENSE TECHNOLOGIES, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

|   | Six Months Ended |                  |
|---|------------------|------------------|
|   | June 27,<br>2003 | June 30,<br>2002 |
| -----   |                  |                  |
| (In thousands)  |                  |                  |
| -----   |                  |                  |
| OPERATING ACTIVITIES:   |                  |                  |
| Net income (loss)   | \$7,504          | \$ ( 6,582)      |
| Adjustments to reconcile net income (loss)<br>to net cash provided by operating activities: |                  |                  |
| Depreciation expense  | 6,753            | 5,393            |
| Amortization expense  | 2,183            | 509              |
| Refinancing costs   | ---              | 20,696           |
| Deferred income taxes   | 3,805            | ( 3,472)         |
| Changes in current assets and liabilities:  |                  |                  |
| Restricted cash   | 692              | 394              |
| Accounts receivable, net  | 618              | ( 4,315)         |
| Inventories, net  | ( 2,090)         | ( 144)           |
| Other current assets  | ( 167)           | ( 1,718)         |
| Accounts payable  | ( 2,617)         | 1,665            |
| Billings in excess of costs and earnings  | 3,044            | ( 1,238)         |
| Other current liabilities   | 4,755            | ( 1,489)         |
| -----   |                  |                  |
| Net cash provided by operating activities   | 24,480           | 9,699            |

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|  |          |           |
|--|----------|-----------|
| INVESTING ACTIVITIES:  |          |           |
| Purchases of property and equipment                          | ( 6,998) | ( 3,740)  |
| Capitalization of internally developed software              | ( 208)   | ( 493)    |
| Signia purchase price adjustments                            | 1,685    | ---       |
| Other  | ---      | ( 123)    |
| -----  |          |           |
| Net cash used in investing activities                        | ( 5,521) | ( 4,356)  |
| -----  |          |           |
| FINANCING ACTIVITIES:  |          |           |
| Proceeds from sale of common stock,<br>net of issuance costs | ---      | 116,688   |
| Issuance of long-term debt                                   | ---      | 85,000    |
| Repayment of long-term debt                                  | (11,643) | (169,823) |
| Payment of refinancing costs                                 | ---      | ( 14,716) |
| Net repayments under revolving credit loans                  | ( 2,500) | ( 8,500)  |
| -----  |          |           |
| Net cash provided by (used in)<br>financing activities       | (14,143) | 8,649     |
| -----  |          |           |
| Net increase in cash   | 4,816    | 13,992    |
| Cash at beginning of period                                  | 8,969    | 3,893     |
| -----  |          |           |
| Cash at end of period  | \$13,785 | \$ 17,885 |
| =====  |          |           |

Supplemental disclosure of noncash  
financing activities:

|   |          |            |
|---|----------|------------|
| Unrealized loss on derivative<br>financial instrument | \$( 239) | \$( 1,075) |
|---|----------|------------|

The accompanying notes are an integral part of these consolidated  
financial statements.

INTEGRATED DEFENSE TECHNOLOGIES, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of Integrated Defense Technologies, Inc. and subsidiaries (the "Company") have been prepared on the same basis as the Company's annual consolidated financial statements and should be read in conjunction with its Annual Report on Form 10-K for the year ended December 31, 2002 filed with the Securities and Exchange Commission on March 28, 2003. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of normal recurring items) necessary for a fair presentation of results for the interim periods presented. The consolidated results for interim periods are not necessarily indicative of the results that may be expected for the full year. Certain prior period amounts have been reclassified to provide comparability with the current presentation.

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### NOTE 2: REFINANCING

On February 27, 2002, the Company completed an initial public offering of 8,000,000 shares of common stock at \$22 per share. In the offering, the Company sold 6,000,000 primary shares, generating net cash proceeds of \$116,688,000. The majority of the proceeds from the offering were used for debt retirement and refinancing. Concurrent with the closing of the offering, the Company repaid the outstanding balances on its revolving credit and term loan agreement and its senior subordinated notes (\$125,836,000 and \$51,250,000, respectively) and replaced the previous revolving credit and term loan facility with a new facility provided by a syndicate of financial institutions.

The Company's new six-year revolving credit and term loan facility, as amended on November 1, 2002 (see Note 3), provides for a total credit facility of up to \$265,000,000, consisting of a \$45,000,000 five-year revolving credit facility, a \$40,000,000 five-year term loan ("Term Loan A") and a \$180,000,000 six-year term loan ("Term Loan B"). Borrowings under the facility are secured by a pledge of substantially all of the Company's assets and bear interest at the base rate or LIBOR plus an applicable margin ranging from 1.00% to 4.00% based upon the Company's leverage ratio. Available borrowings under the revolving credit facility are based upon a borrowing base, which is calculated based upon eligible accounts receivable and inventories as defined in the agreement.

On March 31, 2003, the Company repaid the \$2,500,000 amount outstanding under the revolving credit facility, and on June 27, 2003, it prepaid \$10,000,000 of the balance due under the term loan facility, consisting of \$1,656,000 paid on Term Loan A and \$8,344,000 paid on Term Loan B. This prepayment also served to reduce the Company's remaining scheduled quarterly payments under the term loan facility by approximately 4.7%.

At June 27, 2003, the Company had outstanding borrowings of \$204,375,000 under the facility, consisting of \$33,844,000 under Term Loan A and \$170,531,000 under Term Loan B. In addition, \$14,720,000 of the credit line was allocated to support the Company's letters of credit on that date, leaving available borrowings under the facility of \$30,280,000. The Company has not utilized the revolving credit facility since the March 31, 2003 repayment.

On June 30, 2003, the Company made its scheduled payments on Term Loans A and B of \$1,370,000 and \$429,000, respectively. Current interest rates on the remaining outstanding loan balances are 4.1% and 5.1%, respectively.

At June 27, 2003 and December 31, 2002, the fair values of the Company's borrowings under its revolving credit and term loan facility approximated their carrying values based upon the variable nature of the interest rates. For further information regarding the Company's revolving credit and term loan facility, including information regarding financial covenants and business restrictions associated with the facility, see "Liquidity and Capital Resources" contained in "Management's Discussion and Analysis of

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Financial Condition and Results of Operations" in this quarterly report on Form 10-Q.

In connection with the early retirement and refinancing of its prior credit facility in first quarter 2002, the Company incurred charges totaling \$20,696,000, including prepayment penalties of \$2,565,000, a \$4,833,000 write-off of capitalized debt issuance costs associated with the previous debt, a \$5,727,000 write-off of unamortized discount on its senior subordinated notes, and a \$7,571,000 payment to terminate interest rate swap agreements associated with the retired debt. These charges are reflected as "Refinancing costs" in the Company's consolidated statement of operations for the six months ended June 30, 2002.

### NOTE 3: BUSINESS ACQUISITION

On November 1, 2002, the Company acquired substantially all of the assets and assumed certain of the liabilities of the BAE SYSTEMS Advanced Systems Gaithersburg, Maryland operation (now known as "Signia"). Signia designs and manufactures high performance radio frequency surveillance equipment used in communications intelligence and signals intelligence applications. The Signia operation complements the Company's Communications & Surveillance Systems segment, particularly its Zeta division, which was operationally combined with Signia during the fourth quarter of 2002. In addition to reducing overhead expenses associated with the Zeta division, the integration of Signia into the Communications & Surveillance Systems segment is expected to broaden that segment's capabilities and technological expertise in surveillance and intelligence, while adding valuable new customer relationships.

The aggregate purchase price paid in fourth quarter 2002 was \$149,085,000, including direct acquisition costs, and was financed primarily through an add-on to the Company's revolving credit and term loan facility. (See Note 2 for details of the Company's credit facility.) In March 2003, the Company received a final closing purchase price adjustment of \$1,899,000 in cash from the seller. In addition, during the first six months of 2003, the Company incurred additional expenses related to the acquisition totaling \$214,000. These expenses also resulted in an adjustment to the purchase price and goodwill associated with the acquisition. (See Note 5 following.) The net cash inflow related to these Signia purchase price adjustments of \$1,685,000 is reflected as "Signia purchase price adjustments" in the Company's consolidated statement of cash flows for the six months ended June 27, 2003.

See Note 4 of Notes to Consolidated Financial Statements contained in the Company's 2002 Annual Report to Stockholders for complete details of the Signia acquisition, including the fair values of the assets acquired and liabilities assumed on the date of acquisition. For information regarding the intangible assets acquired, see Note 5 following.

### NOTE 4: INVENTORIES

Inventories consist of the following:

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|   | June 27,<br>2003 | December 31,<br>2002 |
|---|------------------|----------------------|
| (In thousands)                              |                  |                      |
| Stock materials                             | \$16,514         | \$14,983             |
| Work-in-process                             | 11,999           | 10,525               |
| Finished goods                              | 2,065            | 3,363                |
|   | 30,578           | 28,871               |
| Less reserve for excess<br>and obsolescence | 8,582            | 8,629                |
| Inventories, net                            | \$21,996         | \$20,242             |

Inventories are stated at the lower of first-in, first-out ("FIFO") cost or market or valued using other costing methods which approximate the lower of FIFO cost or market. For the purpose of this valuation, market values are estimated based upon assumptions about future demand and market conditions.

Work-in-process and finished goods inventories consist primarily of electronic components for use in fulfilling current and future contracts.

NOTE 5: GOODWILL AND OTHER INTANGIBLE ASSETS

Effective January 1, 2002, the Company adopted the provisions of Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets ("SFAS 142"), under which the Company's goodwill is no longer amortized and is instead subject to annual impairment tests using a fair value based approach. The Company's other recorded intangible assets, substantially all of which were acquired in the Company's November 1, 2002 acquisition of Signia, are being amortized over their remaining estimated useful lives.

Goodwill

The Company completed the transitional impairment testing and reallocation of goodwill to its business units in the second quarter of 2002. For impairment testing purposes, the Company determined the value of its individual business units using a discounted cash flow model, a guideline company model, and a transaction model, and by observation of demonstrable fair values of comparable entities. The Company determined that there was no impairment of its goodwill as of the January 1, 2002 implementation date of SFAS 142.

In fourth quarter 2002, in connection with the combination of its Zeta division with Signia, the Company determined the value of the Zeta division using a discounted cash flow model and wrote off the remaining unamortized goodwill balance associated with the division.

The Company completed its first annual impairment testing of goodwill as of December 31, 2002 using a discounted cash flow model and a transaction model and determined that there was no



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further impairment of its goodwill. There have been no events or changes in circumstances during the first six months of 2003 which would indicate additional impairment of the Company's goodwill.

Changes in the carrying amount of the Company's goodwill during the first six months of 2003 were as follows:

|   | Electronic<br>Combat<br>Systems | Diagnostics<br>& Power<br>Systems | Communications<br>& Surveillance<br>Systems | Total     |
|---|---------------------------------|-----------------------------------|---|-----------|
| (In thousands)                                    |                                 |                                   |   |           |
| Balance as of January 1, 2003                     | \$53,221                        | \$20,075                          | \$70,513                                    | \$143,809 |
| Signia purchase price adjustments<br>(see Note 3) | ---                             | ---                               | (1,685)                                     | (1,685)   |
| Balance as of June 27, 2003                       | \$53,221                        | \$20,075                          | \$68,828                                    | \$142,124 |

### Other Intangible Assets

|                                    | As of June 27, 2003      |                             |                        |
|------------------------------------|--------------------------|-----------------------------|------------------------|
|                                    | Gross Carrying<br>Amount | Accumulated<br>Amortization | Net Carrying<br>Amount |
| (In thousands)                     |                          |                             |                        |
| Trade names and trademarks         | \$ 1,581                 | \$ 105                      | \$ 1,476               |
| Patents and proprietary technology | 13,870                   | 614                         | 13,256                 |
| Customer relationships             | 40,912                   | 880                         | 40,032                 |
| Total                              | \$56,363                 | \$1,599                     | \$54,764               |

Annual amortization expense for each of the next five years should approximate \$2,400,000.

#### NOTE 6: PROPERTY AND EQUIPMENT

Property and equipment, net includes allowances for depreciation of \$77,338,000 and \$71,043,000 at June 27, 2003 and December 31, 2002, respectively.

#### NOTE 7: INTEREST RATE SWAP AGREEMENTS

The Company at times uses interest rate swap agreements to manage the risk associated with interest rate fluctuations on its variable rate debt. In October 2000, the Company entered into three such agreements with notional amounts of \$25,000,000, \$10,000,000, and \$60,000,000, under which the

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Company paid fixed interest rates ranging from 6.39% to 6.75% and received a variable LIBOR-based rate of interest from the holders of the agreements. On March 4, 2002, in connection with its debt retirement and refinancing (see Note 2), the Company paid \$7,571,000 to terminate these interest rate swap agreements. This expense is reflected as a component of "Refinancing costs" in the Company's consolidated statement of operations for the six months ended June 30, 2002.

On December 31, 2002, the Company entered into an interest rate swap agreement with a notional amount of \$115,000,000, under which the Company pays a fixed interest rate of 1.815% and receives a variable LIBOR-based rate of interest from the holder of the agreement. LIBOR approximated 1.4% at December 31, 2002 and 1.1% at June 27, 2003. As such, the swap agreement had a negative fair value of \$458,000 (\$291,000 net of tax benefit) at December 31, 2002 and \$425,000 (\$270,000 net of tax benefit) at June 27, 2003. These fair values, representing the approximate cost of terminating the swap on those dates, are reflected as "Derivative liabilities" and as a component of "Accumulated other comprehensive loss" in the Company's consolidated balance sheets. The interest rate swap agreement is scheduled to terminate in December 2003, and as such, the accumulated other comprehensive loss associated with the agreement, if any, can be expected to be reclassified into earnings during 2003.

The difference between the pay and receive rates of interest on the Company's interest rate swap agreements is charged or credited to interest expense as incurred and reflected as a reclassification adjustment out of other comprehensive income (loss). In the first six months of 2002 and 2003, the Company's swap agreements increased its interest expense by \$830,000 and \$272,000, respectively.

There was no impact to earnings due to hedge ineffectiveness during the first six months of 2002 and 2003. The Company does not use derivative financial instruments for speculative or trading purposes.

### NOTE 8: EARNINGS (LOSS) PER SHARE ("EPS")

The Company reports both basic and diluted EPS figures. Basic EPS is computed using the weighted average number of common shares outstanding. Diluted EPS is computed using the weighted average number of common and equivalent common shares outstanding. Historically, common stock warrants have been the Company's only common stock equivalent and have been included in the Company's EPS calculations only if dilutive.

On February 5, 2002, the Company's Board of Directors approved a 198.6359 to 1 common stock split. All share and per share amounts for the six months ended June 30, 2002 reflect this stock split.

On February 27, 2002, in connection with its initial public stock offering, the Company issued 6,000,000 additional shares of common stock, and warrant holders converted outstanding warrants into 235,749 shares of the Company's common stock. On September 6, 2002, warrant holders converted the remaining outstanding warrants into 1,526,939 shares of restricted common stock. The Company no longer has any common stock

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warrants outstanding.

Common stock warrants outstanding during the quarter and six months ended June 30, 2002 equated to 1,526,946 dilutive weighted-average equivalent shares and 1,601,187 anti-dilutive weighted-average equivalent shares for the respective periods. The Company had no common stock warrants outstanding during the six months ended June 27, 2003.

### NOTE 9: COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) includes net income (loss) as well as all other nonowner changes in equity. The components of the Company's comprehensive income (losses) for the quarters and six month periods ended June 27, 2003 and June 30, 2002 are presented below, net of related income tax effects. See Note 7 for further information regarding the interest rate swap agreements used by the Company and the impact of those agreements on its consolidated financial position and results of operations.

|   | Quarter Ended    |                  | Six Months Ended |                  |
|---|------------------|------------------|------------------|------------------|
|   | June 27,<br>2003 | June 30,<br>2002 | June 27,<br>2003 | June 30,<br>2002 |
| (In thousands)  |                  |                  |                  |                  |
| Net income (loss)   | \$4,475          | \$4,490          | \$7,504          | \$(6,582)        |
| Other comprehensive income (loss):  |                  |                  |                  |                  |
| Unrealized losses on interest rate swap agreements                            | (37)             | ---              | (152)            | (656)            |
| Realized losses on interest rate swap agreements charged to net income (loss) | 97               | ---              | 173              | 5,198            |
| Minimum pension liability adjustment  | 113              | (46)             | 100              | (25)             |
| Comprehensive income (loss)   | \$4,648          | \$4,444          | \$7,625          | \$(2,065)        |

### NOTE 10: SEGMENT INFORMATION

The Company's business presently consists of three operating segments: Electronic Combat Systems, Diagnostics & Power Systems, and Communications & Surveillance Systems. These reportable segments are defined primarily by their economic characteristics, the nature of their products and services, and by their class of customer.

The Electronic Combat Systems segment designs, integrates, manufactures, and sells electronics and avionics equipment primarily to the U.S. Government for military, civil, and governmental uses, and designs, manufactures, and supports advanced test and evaluation systems, rangeless air combat training systems, threat simulation equipment, high power transmitters, and control subsystems for both guided bombs and missile launching systems for the U.S. Department of Defense, major defense prime contractors, and foreign government defense agencies.

The Diagnostics & Power Systems segment is a contractor

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primarily to the U.S. Government and to foreign governments, and designs, manufactures, and supports test equipment, vehicle electronics systems, and energy management systems primarily for military combat vehicle applications.

The Communications & Surveillance Systems segment designs and manufactures meteorological surveillance and analysis systems, more commonly known as Doppler weather radar systems, and designs and produces advanced electronics systems, subsystems, components, and radio frequency surveillance equipment for the defense, aerospace, and communications industries for U.S. and foreign government agencies and commercial customers.

The Company evaluates the performance of its operating segments based upon revenue and earnings before interest, taxes, depreciation, and amortization ("EBITDA") (1), calculated as income from operations plus depreciation and amortization expense. The accounting policies of the operating segments are consistent across segments and are the same as those used in preparation of the consolidated financial statements of the Company. (See Note 2 of Notes to Consolidated Financial Statements included in the Company's 2002 Annual Report to Stockholders.) Sales among the operating segments are insignificant. The Company's corporate expenses are allocated in full to the segments on the basis of relative employment, revenue, and selected assets. Corporate assets are included in "All other" in the following table.

Set forth below are revenue and EBITDA by operating segment for the quarters and six month periods ended June 27, 2003 and June 30, 2002.

|                                       | Quarter Ended    |                  | Six Months Ended |                  |
|---------------------------------------|------------------|------------------|------------------|------------------|
|                                       | June 27,<br>2003 | June 30,<br>2002 | June 27,<br>2003 | June 30,<br>2002 |
| (In thousands)                        |                  |                  |                  |                  |
| Revenues from Unaffiliated Customers: |                  |                  |                  |                  |
| Electronic Combat Systems             | \$37,276         | \$35,904         | \$ 68,919        | \$ 68,125        |
| Diagnostics & Power Systems           | 22,797           | 19,902           | 41,071           | 41,587           |
| Communications & Surveillance Systems | 33,345           | 16,253           | 64,327           | 30,485           |
| All other                             | ---              | 40               | ---              | 295              |
| <b>Total</b>                          | <b>\$93,418</b>  | <b>\$72,099</b>  | <b>\$174,317</b> | <b>\$140,492</b> |
| Other Financial Information:          |                  |                  |                  |                  |
| EBITDA:                               |                  |                  |                  |                  |
| Electronic Combat Systems             | \$ 6,867         | \$6,408          | \$11,787         | \$11,630         |
| Diagnostics & Power Systems           | 2,542            | 2,110            | 4,644            | 4,287            |
| Communications & Surveillance Systems | 4,913            | 2,455            | 9,900            | 4,524            |
| All other                             | 26               | (134)            | 79               | (318)            |
| <b>Total</b>                          | <b>\$14,348</b>  | <b>\$10,839</b>  | <b>\$26,410</b>  | <b>\$20,123</b>  |

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The increase in Communications & Surveillance Systems' revenue and EBITDA is due primarily to the acquisition of Signia in the fourth quarter of 2002. Signia's revenue and EBITDA for the first six months of 2003 totaled \$36,633,000 and \$7,494,000, respectively.

- (1) EBITDA is not a presentation made in accordance with accounting principles generally accepted in the United States ("U.S. GAAP"), and as such, it should not be considered in isolation or as a substitute for net income (loss), cash flows from operating activities, or other income or cash flow statement data prepared in accordance with U.S. GAAP, or as a measure of profitability or liquidity. The Company monitors EBITDA by segment to determine each segment's ability to satisfy its debt service, capital expenditure, and working capital requirements and because certain covenants in the Company's revolving credit and term loan facility are based upon similar measures. EBITDA does not fully consider the impact of investing or financing transactions as it specifically excludes depreciation and amortization charges, which should be considered in the overall evaluation of results. Additionally, the Company's EBITDA is not necessarily comparable to other similarly titled captions used by other companies. A reconciliation of the Company's EBITDA to income (loss) before income taxes is presented in the following table.

Reconciliation of EBITDA to income (loss) before income taxes:

|   | Quarter Ended    |                  | Six Months Ended |              |
|---|------------------|------------------|------------------|--------------|
|   | June 27,<br>2003 | June 30,<br>2002 | June 27,<br>2003 | June<br>2002 |
| (In thousands)                              |                  |                  |                  |              |
| EBITDA                                      | \$14,348         | \$10,839         | \$26,410         | \$20,126     |
| Less: Depreciation and amortization expense | 4,485            | 2,974            | 8,936            | 5,900        |
| Interest expense                            | 3,001            | 1,027            | 6,087            | 4,850        |
| Refinancing costs                           | ---              | ---              | ---              | 20,690       |
| Add back other income                       | 185              | 231              | 430              | 250          |
| Income (loss) before income taxes           | \$7,047          | \$7,069          | \$11,817         | \$(11,080)   |

The following table presents total assets for each of the Company's operating segments as of June 27, 2003 and December 31, 2002.

|                             | June 27,<br>2003 | December 31,<br>2002 |
|-----------------------------|------------------|----------------------|
| (In thousands)              |                  |                      |
| Total assets:               |                  |                      |
| Electronic Combat Systems   | \$161,126        | \$163,615            |
| Diagnostics & Power Systems | 54,711           | 57,216               |

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|                                       |           |           |
|---------------------------------------|-----------|-----------|
| Communications & Surveillance Systems | 207,798   | 202,004   |
| All other                             | 23,223    | 24,865    |
| -----                                 |           |           |
| Total                                 | \$446,858 | \$447,700 |
| =====                                 |           |           |

### NOTE 11: RECENT ACCOUNTING PRONOUNCEMENTS

In fourth quarter 2002, the Company early adopted the provisions of FASB Statement of Financial Accounting Standards No. 145 ("SFAS 145"), which rescinded FASB Statement of Financial Accounting Standards No. 4, Reporting Gains and Losses from Extinguishment of Debt ("SFAS 4"), and made other technical corrections to existing authoritative pronouncements. SFAS 4 required companies to classify all gains and losses from extinguishment of debt as extraordinary items, net of the related tax effects, in their statements of operations. SFAS 145 requires gains and losses from extinguishment of debt to be classified as income or loss from continuing operations unless they meet the criteria for classification as extraordinary items contained in Accounting Principles Board Opinion No. 30. In accordance with the provisions of SFAS 145, the Company has reclassified its first quarter 2002 early debt extinguishment loss of \$13,125,000, which was previously classified as an extraordinary item, net of tax, into its loss from continuing operations. This loss is included in "Refinancing costs" in the Company's consolidated statement of operations for the six months ended June 30, 2002. See Note 2 for further discussion of the Company's refinancing costs.

### NOTE 12: COMMITMENTS AND CONTINGENCIES

Retention Agreements - In March 2003, the Company's Board of Directors, in connection with its decision to explore strategic alternatives for the Company and thereby maximize stockholder value, adopted a retention incentive program for certain key employees to ensure their continuous full-time employment with the Company. The employees covered under this program are eligible to receive special retention bonuses in varying fixed amounts in the event of a sale, merger, consolidation, or other business combination resulting in a change of control of the Company. The aggregate amount of the Company's contingent liability with respect to the retention agreements under this program is \$3,200,000, but such amount is not payable absent a change of control event. Additionally, all agreements under this program will terminate if such an event has not occurred prior to December 31, 2003.

Product Warranties - Due to the nature and variability of its products and customers, the Company has no standard warranty policy applicable to all of its products and business segments. When applicable, warranties are limited to defects in material and workmanship, with specific terms and duration based upon contractual agreements with individual customers.

For products sold with warranties, a provision for future warranty costs is estimated based upon historical experience and recorded when the product is shipped. The adequacy of the recorded warranty liability is assessed each quarter and adjusted as necessary.

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The Company's liability for estimated warranty obligations is included as a component of "Other accrued expenses" in its consolidated balance sheets. Changes in the Company's warranty liability during the six months ended June 27, 2003 were as follows:

|   | (In thousands) |
|---|----------------|
|   | -----          |
| Balance at December 31, 2002                          | \$ 2,522       |
| Product warranty accrual                              | 118            |
| Warranty costs incurred                               | (95)           |
|   | -----          |
| Balance at March 28, 2003                             | 2,545          |
| Product warranty accrual                              | 236            |
| Transfer from program estimate<br>of cost to complete | 1,809          |
| Warranty costs incurred                               | (416)          |
|   | -----          |
| Balance at June 27, 2003                              | \$4,174        |
|   | =====          |

Letters of Credit - At June 27, 2003, the Company had outstanding letters of credit of approximately \$14,720,000. These letters of credit, substantially all of which expire within a year, relate primarily to the Company's contracts with foreign governments.

Claims and Legal Proceedings - As further described in the Company's 2002 Annual Report to Stockholders, the Company is involved in various legal actions arising in the normal course of its business, including a National Park Service investigation regarding the presence of residual radioactive materials and contamination at a uranium mine previously owned by a predecessor of one of the Company's subsidiaries. Although the ultimate cost of these matters cannot be predicted with certainty, the outcomes of such legal actions are not expected, either individually or in the aggregate, to result in a material adverse effect on the Company's business, results of operations, or financial condition. There were no material developments with respect to these matters during the first six months of 2003.

### ITEM 2.

#### INTEGRATED DEFENSE TECHNOLOGIES, INC. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

##### General

Integrated Defense Technologies, Inc. (the "Company") is a designer and developer of advanced electronics and technology products for the defense and intelligence industries. The Company's products are installed on or used in support of a broad array of military platforms in order to enhance their operational performance

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or extend their useful lives. The Company's customers include all branches of the military services, major domestic prime defense contractors such as The Boeing Company, General Dynamics Corporation, Lockheed Martin Corporation, Northrop Grumman Corporation, Raytheon Company, and United Defense Industries, Inc., foreign defense contractors, foreign governments, and U.S. Government agencies.

The Company's contracts typically fall into two categories: cost-plus and fixed-price contracts. Contracts for research, engineering, prototypes, repair and maintenance, and similar are typically cost-plus arrangements. Customer-funded research and development costs are typically included in the Company's contracts and booked as revenue and cost of revenue.

In a fixed-price contract, the price is not subject to adjustment based upon cost incurred to perform the required work under the contract. In a cost-plus contract, the Company is reimbursed for allowable incurred costs plus a fee, which may be fixed or variable. The price on a cost-plus contract is based upon allowable costs incurred, but generally is subject to contract funding limitations. Under fixed-price contracts, the Company agrees to perform for a predetermined contract price. Although fixed-price contracts generally permit the Company to keep profits if costs are less than projected, the Company bears the risk that increased or unexpected costs may reduce profit or cause the Company to sustain losses on the contracts. Generally, fixed-price contracts offer higher margins than cost-plus type contracts.

All of the Company's domestic U.S. Government contracts and subcontracts are subject to audit and various cost controls and include standard provisions for termination at the convenience of the U.S. Government or for default. The Department of Defense generally has the right to object to costs as not allowable or as unreasonable, which can increase the level of costs the Company bears. Multi-year U.S. Government contracts and related orders are subject to cancellation if funds for contract performance for any subsequent year are not available. Foreign government contracts generally include comparable provisions relating to termination at the convenience of the foreign government or for default.

Prior to its November 1, 2002 acquisition of Signia (see the Company's Annual Report on Form 10-K for the year ended December 31, 2002 for further discussion), the Company accounted for substantially all of its contracts using the percentage-of-completion method of accounting. As revenues of the Signia business are generated primarily from shorter-term production jobs which are recognized at delivery, the Company's mix of percentage-of-completion revenues to total revenues has declined to approximately 80%. Under the percentage-of-completion method of accounting, revenue is matched with the cost incurred on each unit produced at the time the Company recognizes its sale based upon an estimate of the gross profit margin the Company expects to receive over the life of the contract. The Company currently evaluates its estimates of gross margin on a monthly basis. In addition, the Company uses the cumulative catch-up method to recognize its changes in estimates of sales and gross margins during the period in which those changes are determined. The Company charges any anticipated losses on a contract to operations as soon as those losses are determined. The principal components of the Company's cost of revenue are materials, subcontractor costs, labor, and overhead. The Company charges all of these costs to the respective contracts as incurred.



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The Company expenses operating costs such as sales and marketing expenses, general and administrative expenses, independent research and development costs, and bid and proposal costs in the period incurred. The major components of these costs are compensation and overhead. Capitalized debt issuance costs, qualifying software development costs, and intangible assets are amortized over their useful lives, with the amortization of capitalized software development costs included as a component of the Company's cost of revenue. Since January 1, 2002, the Company has been subject to a new accounting standard under which it no longer amortizes goodwill, although it must test its goodwill periodically for impairment.

The Company's results of operations, particularly its revenue and its cash flows, may vary significantly from period to period depending upon the timing of delivery of finished products, the terms of contracts, and the level of export sales. As a result, period-to-period comparisons may show substantial changes disproportionate to the Company's underlying business activity. Accordingly, the Company does not believe that its quarterly results of operations are necessarily indicative of results for future periods.

### Forward Looking Statements

The information contained in this report includes forward-looking statements, including in particular statements about plans, strategies, and prospects under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations." Words such as "may," "will," "expect," "anticipate," "believe," "estimate," "plan," "intend," and similar expressions in this report identify forward-looking statements. These forward-looking statements are based upon current views with respect to future events and financial performance of the Company based upon assumptions made by management. Actual results could differ materially from those projected in the forward-looking statements.

The Company's forward-looking statements are subject to risks and uncertainties, including:

- o the Company's dependence upon the defense industry and the business risks peculiar to that industry, including changing priorities due to geopolitical conditions or otherwise, or reductions in the U.S. Government defense budget;
- o the Company's ability to obtain future government contracts on a timely basis;
- o the availability of government funding and customer requirements;
- o the potential development of new and competing technologies and the Company's ability to compete technologically;
- o difficulties encountered in the integration of acquired businesses;
- o general economic conditions, the competitive environment of the defense industry, international business and political conditions, and timing of awards and contracts; and

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- o other factors described under "Factors Which May Affect Financial Condition and Future Results" in the Company's Annual Report on Form 10-K for the year ended December 31, 2002.

As for the forward-looking statements that relate to future financial results and other projections, actual results could be different due to the inherent uncertainty of estimates, forecasts, and projections and may be better or worse than anticipated. Given these uncertainties, no reliance should be placed upon forward-looking statements. Forward-looking statements represent the Company's estimates and assumptions only as of the date they were made. The Company expressly disclaims any duty to provide updates to forward-looking statements and the estimates and assumptions associated with them after the date of this report in order to reflect changes in circumstances or expectations or occurrence of unanticipated events, except to the extent required by applicable securities laws.

### Results of Operations

The following tables summarize the Company's operating information as a percentage of revenue and its segment data for the quarters and six month periods ended June 27, 2003 and June 30, 2002:

|  | Quarter Ended    |                  | Six Months Ended |                  |
|--|------------------|------------------|------------------|------------------|
|  | June 27,<br>2003 | June 30,<br>2002 | June 27,<br>2003 | June 30,<br>2002 |
| -----  |                  |                  |                  |                  |
| Statement of operations and other financial information: |                  |                  |                  |                  |
| Revenue  | 100.0%           | 100.0%           | 100.0%           | 100.0%           |
| Cost of revenue  | 68.5             | 69.7             | 68.3             | 70.6             |
| -----  |                  |                  |                  |                  |
| Gross profit   | 31.5             | 30.3             | 31.7             | 29.4             |
| Sales and marketing expense                              | 4.3              | 4.0              | 4.4              | 4.8              |
| General and administrative expense                       | 8.7              | 8.9              | 9.3              | 8.5              |
| Research and development and bid and proposal expenses   | 7.1              | 6.2              | 7.1              | 5.7              |
| Amortization expense                                     | .8               | .3               | .9               | .3               |
| -----  |                  |                  |                  |                  |
| Income from operations                                   | 10.6%            | 10.9%            | 10.0%            | 10.1%            |
| =====  |                  |                  |                  |                  |
| EBITDA (1)   | 15.4%            | 15.0%            | 15.2%            | 14.3%            |
| =====  |                  |                  |                  |                  |

### Operations information by segment and other financial information: (In millions)

|                                       |        |        |         |         |
|---------------------------------------|--------|--------|---------|---------|
| Revenue:                              |        |        |         |         |
| Electronic Combat Systems             | \$37.3 | \$35.9 | \$68.9  | \$ 68.1 |
| Diagnostics & Power Systems           | 22.8   | 19.9   | 41.1    | 41.6    |
| Communications & Surveillance Systems | 33.3   | 16.3   | 64.3    | 30.5    |
| Other                                 | ---    | ---    | ---     | .3      |
| -----                                 |        |        |         |         |
| Total revenue                         | \$93.4 | \$72.1 | \$174.3 | \$140.5 |
| =====                                 |        |        |         |         |

Gross profit:

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|                                       |        |        |        |         |
|---------------------------------------|--------|--------|--------|---------|
| Electronic Combat Systems             | \$11.4 | \$11.8 | \$20.1 | \$ 21.5 |
| Diagnostics & Power Systems           | 5.5    | 4.7    | 10.3   | 9.1     |
| Communications & Surveillance Systems | 12.5   | 5.3    | 24.8   | 10.7    |
| Other                                 | ---    | ---    | ---    | .1      |
| -----                                 |        |        |        |         |
| Total gross profit                    | \$29.4 | \$21.8 | \$55.2 | \$ 41.4 |
| =====                                 |        |        |        |         |
| EBITDA (1) :                          |        |        |        |         |
| Electronic Combat Systems             | \$6.9  | \$ 6.4 | \$11.8 | \$ 11.6 |
| Diagnostics & Power Systems           | 2.5    | 2.1    | 4.6    | 4.3     |
| Communications & Surveillance Systems | 4.9    | 2.5    | 9.9    | 4.5     |
| Other                                 | ---    | (.2)   | .1     | (.3)    |
| -----                                 |        |        |        |         |
| Total EBITDA                          | \$14.3 | \$10.8 | \$26.4 | \$ 20.1 |
| =====                                 |        |        |        |         |

(1) The Company's EBITDA (earnings before interest, taxes, depreciation, and amortization) represents income (loss) from operations plus depreciation and amortization expense. EBITDA is not a presentation made in accordance with accounting principles generally accepted in the United States ("U.S. GAAP"), and as such, it should not be considered in isolation or as a substitute for net income (loss), cash flows from operating activities, or other income or cash flow statement data prepared in accordance with U.S. GAAP or as a measure of profitability or liquidity. EBITDA is the measure of segment profit or loss which is reviewed by the Company's Chief Executive Officer and Board of Directors, and as such, in accordance with the provisions of Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information, it is the measure used for the Company's segment disclosures. The Company monitors EBITDA by segment to determine each segment's ability to satisfy its debt service, capital expenditure, and working capital requirements and because certain covenants in the Company's revolving credit and term loan facility are based upon similar measures. EBITDA does not fully consider the impact of investing or financing transactions as it specifically excludes depreciation and amortization charges, which should be considered in the overall evaluation of results. Additionally, the Company's EBITDA is not necessarily comparable to other similarly titled captions used by other companies. For a reconciliation of the Company's EBITDA to income (loss) before income taxes, see Note 10 of Notes to Consolidated Financial Statements contained in this quarterly report on Form 10-Q.

Results of Operations. In second quarter 2003, the Company earned net income of \$4.5 million on revenues of \$93.4 million, up from a first quarter 2003 net income of \$3.0 million on revenues of \$80.9 million and flat with second quarter 2002 net income of \$4.5 million on revenues of \$72.1 million.

For the first half of 2003, the Company earned net income of \$7.5 million on revenues of \$174.3 million, compared to a first half 2002 net loss of \$6.6 million on revenues of \$140.5 million. The Company's first half 2002 results included charges totaling \$20.7 million (\$12.6 million after tax, or \$0.71 per share) for debt retirement and refinancing concurrent with the Company's February 27, 2002 initial public offering. These charges, which included prepayment penalties, payments to terminate interest rate swap agreements, and write-offs of capitalized debt issuance costs and unamortized discounts associated with the extinguished debt, are

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reflected as "Refinancing costs" in the Company's consolidated statement of operations for the first six months of 2002. See Note 2 of Notes to Consolidated Financial Statements contained in this quarterly report on Form 10-Q for further details regarding these charges.

Revenue. Revenue for second quarter 2003 was \$93.4 million, up 15% from the first quarter 2003 level and up 30% from the same prior year period. Year to date revenues are \$174.3 million, up 24% from the first six months of 2002.

The revenue improvement over the prior year levels is directly attributable to the Company's acquisition of Signia in fourth quarter 2002. Signia's revenues, which are included in the results of the Company's Communications & Surveillance Systems segment, totaled \$19.2 million and \$36.6 million, respectively, for the second quarter and first half of 2003. Compared to the first quarter of the year, all of the Company's operating segments experienced second quarter revenue growth as the first quarter was negatively impacted by booking and program delays.

The Company's Communications & Surveillance Systems segment earned revenues of \$33.3 million in second quarter 2003 and \$64.3 million year to date. Excluding the impact of Signia, the segment's second quarter revenues were down 13% from the same prior year period, but up 5% from the first quarter 2003 level, and its year to date revenues were down 9% from the first half 2002 level. Portions of the business of this segment are subject to frequent delays in international business. However, the negative impact of these booking delays on the segment's revenues was partially offset by revenues generated from strong first quarter 2003 domestic television orders for the segment's Doppler weather radar systems.

The Company's Electronic Combat Systems segment earned revenues of \$37.3 million in second quarter 2003, up 18% and 4%, respectively, from the first quarter 2003 and second quarter 2002 levels. Year to date revenues were \$68.9 million, up 1% from the first half 2002 level. Current year revenues for this segment, particularly those for the first quarter, were negatively impacted by a temporary delay in a large U.S. Air Force program. This program is now in progress and began to benefit the segment's revenues in the second quarter. In addition, a loss of congressional funding for programs of a portion of the segment's business has acted to lower current year revenue growth in the segment.

Revenues for the Company's Diagnostics & Power Systems segment were \$22.8 million for the quarter, up 25% from the first quarter 2003 level and 15% from the same prior year period. Year to date revenues were \$41.1 million, down 1% from the first half 2002 level. This segment had a very strong first quarter 2002 due to strong fourth quarter 2001 orders for embedded diagnostics, additions to the scope of the Abrams Systems Technical Support program, and earlier than expected booking of the Common Support Function Module program. Revenues for this segment continued to be strong in second quarter 2002 as the result of these programs and an early contract award for the 10th Year Power Supplies and Displays program. The segment's 2003 revenues have been negatively impacted by various program delays, though some recovery occurred in the second quarter.

Year to date bookings for the Company's Electronic Combat Systems, Communications & Surveillance Systems, and Diagnostics &

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Power Systems segments totaled \$68.2 million, \$66.1 million, and \$32.1 million, respectively. The program delays experienced in all of these operating segments relate primarily to timing issues, due in part to Department of Defense attention to the Iraqi conflict.

**Gross Profit.** The Company's gross profit for the quarter was \$29.4 million, up from \$25.8 million in first quarter 2003 and \$21.8 million in second quarter 2002. Year to date gross profit was \$55.2 million, up from \$41.4 million in the first half of 2002. The dollar increases in gross profit were the direct result of the previously described revenue increases.

As a percentage of revenue, gross profit for the quarter was 31.5%, relatively flat with the first quarter 2003 level and up 1.2 points from the same prior year period. Year to date gross profit was 31.7% of revenue, up 2.3 points from the first half of 2002. First half gross profit margins have been unusually high due to high margins earned by the newly acquired Signia business, as its first half sales mix included more high margin products.

**Sales and Marketing Expense.** The Company's sales and marketing expense for second quarter 2003 was \$4.0 million, up \$.3 million from the first quarter 2003 level and \$1.2 million from the same prior year period. Year to date expenses were \$7.7 million, up \$1.0 million from the first half 2002 level. The expense increases from the prior year levels were primarily the result of the Signia acquisition. Signia's sales and marketing expense for the second quarter and first half of 2003 approximated \$1.0 million and \$2.0 million, respectively. Excluding the impact of Signia, Communications & Surveillance Systems' and Electronic Combat Systems' year to date expenses declined by \$.2 million and \$.7 million, respectively, from the first half 2002 levels due to declines in commission expenses resulting from a lower mix of international revenues. Commission expenses are generally higher on international jobs and will vary from quarter to quarter with the mix of international revenues to total revenues. Diagnostics & Power Systems' expenses were relatively flat with the first half 2002 level.

As a percentage of revenue, sales and marketing expense has declined from 4.8% in the first half of 2002 to 4.4% in the current year period as the result of the shift in revenue mix toward domestic jobs.

**General and Administrative Expense.** The Company's general and administrative expense for second quarter 2003 was \$8.1 million, flat with the first quarter 2003 level and up \$1.7 million from the same prior year period. Year to date expenses were \$16.3 million, up \$4.3 million from the first half 2002 level. Signia accounted for approximately \$1.1 million of the increase from second quarter 2002 and \$2.1 million of the year to date increase. The remainder of the expense increases over the prior year levels was due to bad debt expenses incurred by the Company's Diagnostics & Power Systems segment, additional spending associated with the operational combination of Zeta and Signia, and incremental expenses associated with public company status for the entire first half of 2003. Excluding the impact of Signia, Electronic Combat Systems', Diagnostics & Power Systems' and Communications & Surveillance Systems' year to date general and administrative expenses increased by \$.8 million, \$.8 million, and \$.7 million, respectively.

As a percentage of revenue, general and administrative expense

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has increased from 8.5% in the first half of 2002 to 9.3% in the current year period due to the aforementioned factors.

Research and Development and Bid and Proposal Expenses. The Company's research and development and bid and proposal expenses were \$6.7 million for second quarter 2003, up \$1.1 million from the first quarter 2003 level and \$2.2 million from the same prior year period. Year to date expenses were \$12.3 million, up \$4.2 million from the first half 2002 level. Signia's expenses, which totaled \$2.2 million for second quarter 2003 and \$4.5 million year to date, accounted for essentially all of the increase from the prior year levels. Excluding the impact of Signia, Diagnostics & Power Systems' and Communications & Surveillance Systems' year to date expenses increased by \$.2 million and \$.3 million, respectively, while Electronic Combat Systems' expenses were down \$.8 million from an unusually high first half 2002 level caused by a higher level of bid and proposal activity.

Other than the expenses incurred by Signia, most of the Company's first quarter research and development expenses related to projects which were carried over from 2002. In second quarter 2003, the Company's research and development spending began to increase due to commencement of new projects. Bid and proposal expenses also increased in the second quarter due to an increase in the number of projects being proposed. Both bid and proposal and research and development expenses may continue to increase in the second half of the year.

As a percentage of revenue, research and development and bid and proposal expenses were 7.1% for both the second quarter and first half of 2003, up from 5.7% in the first half of 2002.

Amortization Expense. The Company's amortization expense, excluding amounts included in cost of revenue for amortization of its internally developed software, was \$.8 million and \$1.5 million, respectively, in the second quarter and first half of 2003, up from \$.2 million and \$.4 million, respectively, in the comparable prior year periods. The Company's amortization expense increase is the direct result of the Signia acquisition in fourth quarter 2002. See Note 5 of Notes to Consolidated Financial Statements contained in this quarterly report on Form 10-Q for details of the Company's intangible assets, substantially all of which were acquired in the purchase of Signia.

Income from Operations. The Company's income from operations was \$9.9 million, or 10.6% of revenue, for second quarter 2003, up from \$7.6 million, or 9.4% of revenue, in first quarter 2003 and \$7.9 million, or 10.9% of revenue, in second quarter 2002. Year to date, the Company's income from operations was \$17.5 million, or 10.0% of revenue, up from \$14.2 million, or 10.1% of revenue, for first half 2002, despite the increase in amortization expense.

Communications & Surveillance Systems' operating income for the second quarter and first half of 2003 was \$3.2 million and \$6.4 million, respectively, up by approximately \$1.2 million and \$2.9 million, respectively, from the comparable prior year levels. Signia contributed \$2.6 million and \$5.3 million, respectively, to the segment's second quarter and first half 2003 operating income. However, this increase was offset by losses incurred by the segment's Zeta division, additional expenses associated with the combination of Zeta and Signia, and reduced revenues and margins resulting from slow international orders. Operating earnings for

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this segment should improve in the second half of the year as the transition of Zeta into Signia is complete.

Diagnostics & Power Systems' operating income for the second quarter and first half of 2003 was \$2.0 million and \$3.7 million, respectively, up by approximately \$.4 million and \$.3 million, respectively, from the comparable prior year levels. Improvements in the segment's gross profit margin from the prior year levels were partially offset by bad debt expenses incurred in the first half of 2003.

Electronic Combat Systems' operating results for the second quarter and first half of 2003 were relatively flat with those for the comparable prior year levels on flat revenues and gross profit margins resulting from booking and program delays.

Interest Expense. The Company's interest expense for the second quarter and first half of 2003 was \$3.0 million and \$6.1 million, respectively, up \$2.0 million and \$1.2 million, respectively, from the comparable prior year levels. The interest expense increase from the first half 2002 level was due primarily to the additional debt incurred in connection with the fourth quarter 2002 acquisition of Signia. See "Liquidity and Capital Resources" following for further information regarding the Company's financing activities.

Income Tax Expense. In the second quarter and first half of 2003, the Company recorded income tax expense of \$2.6 million and \$4.3 million, respectively, or 36.5% of pretax income. The Company recorded income tax expense of \$2.6 million, or 36.5% of pretax income, in second quarter 2002 and an income tax benefit of \$4.5 million, or 40.6% of pretax loss, in first half 2002. The Company's effective income tax rates exceeded the U.S. federal statutory rates in all periods due primarily to state income taxes and to non-deductible expenses such as meals and entertainment.

EBITDA. The Company's EBITDA was \$14.3 million, or 15.4% of revenue, for second quarter 2003, up from \$12.1 million, or 15.0% of revenue, in first quarter 2003 and \$10.8 million, or 15.0% of revenue, in second quarter 2002. Year to date, the Company's EBITDA was \$26.4 million, or 15.2% of revenue, up from \$20.1 million, or 14.3% of revenue, for the first half of 2002.

Communications & Surveillance Systems' EBITDA for the second quarter and first half of 2003 was \$4.9 million and \$9.9 million, respectively, up \$2.4 million and \$5.4 million, respectively, from the comparable prior year periods. The improvement from the prior year levels is due primarily to the acquisition of Signia in fourth quarter 2002, though losses incurred by the segment's Zeta division and reduced revenues and margins resulting from a slowdown in international orders served to partially offset this positive impact.

Diagnostics & Power Systems' EBITDA for the second quarter and first half of 2003 was \$2.5 million and \$4.6 million, respectively, up \$.4 million and \$.3 million, respectively, from the comparable prior year periods. The current year improvement was primarily the result of improved gross margins, partially offset by increased bad debt expenses.

Electronic Combat Systems' EBITDA for the second quarter and first half of 2003 was \$6.9 million and \$11.8 million,

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respectively, up \$.5 million and \$.2 million, respectively, from the comparable prior year periods. The negative effects of bookings and program delays on the segment's revenues and gross margins were offset by declines in the segment's operating expenses.

### Liquidity and Capital Resources

In the first six months of 2003, the Company generated positive cash of \$4.8 million, primarily from its operations, compared to a net cash generation of \$14.0 million in the first half of 2002 from its operations and the net proceeds of its initial public offering and debt refinancing.

Year to date cash provided by operations totaled \$24.5 million, compared to \$9.7 million generated in the first half of 2002. The significant improvement from the prior year period reflects improvements in the Company's operating earnings and working capital management.

Capital expenditures in the first half of 2003 were \$7.2 million, up \$3.0 million from the first half of 2002. The Company's capital expenditures consist primarily of purchases of engineering equipment, office equipment, and building and leasehold improvements. Due to the nature of the Company's business, capital expenditures historically have not been substantial. The increase in the first half of 2003 was due primarily to additional investments by Electronic Combat Systems in airborne instrumentation pods which are leased to the U.S. Air Force in Europe. The Company expects that its total capital expenditures for 2003 will approximate \$10 million.

In first quarter 2002, the Company completed an initial public offering of 8 million shares of common stock at \$22 per share. In the offering, the Company sold 6 million primary shares, generating net cash proceeds of approximately \$116.7 million. Concurrent with the closing of the offering, the Company repaid the outstanding balances of its revolving credit and term loan agreement and its senior subordinated notes (\$125.8 million and \$51.3 million, respectively) and replaced the previous revolving credit and term loan facility with a new facility provided by a syndicate of financial institutions. Refinancing costs paid in connection with this early retirement and refinancing of the credit facility totaled \$14.8 million (\$14.7 million of which was paid in the first half of 2002), including prepayment penalties of \$2.6 million, new debt issuance costs of \$4.6 million, and a \$7.6 million payment to terminate interest rate swap agreements associated with the extinguished debt. This new credit facility provided financing of up to \$125 million, consisting of a \$40 million five-year revolving credit facility, a \$40 million five-year term loan, and a \$45 million six-year term loan.

On November 1, 2002, in connection with the Signia acquisition, the Company amended and restated its revolving credit and term loan facility. The amendment increased the six-year term loan by \$135 million, increased availability under the revolving credit facility by \$5 million, and updated the financial covenants in the agreement to reflect the integration of Signia into the Company's Communications & Surveillance Systems segment.

On March 31, 2003, the Company repaid the \$2.5 million amount outstanding under the revolving credit facility, and on June 27, 2003, it prepaid \$10 million of the balance due under the term loan



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facility, consisting of \$1.7 million paid on the five-year term loan and \$8.3 million paid on the six-year term loan. This prepayment also served to reduce the Company's remaining scheduled quarterly payments under the term loan facility by approximately 4.7%.

At June 27, 2003, the Company had outstanding borrowings of \$204.4 million under the facility, consisting of \$33.8 million under the five-year term loan and \$170.5 million under the six-year term loan. In addition, \$14.7 million of the credit line was allocated to support the Company's letters of credit on that date, leaving available borrowings under the facility of \$30.3 million. The Company has not utilized the revolving credit facility since the March 31, 2003 repayment.

On June 30, 2003, the Company made its scheduled payments on the five- and six-year term loans of \$1.4 million and \$.5 million respectively. Current interest rates on the remaining outstanding loan balances are 4.1% and 5.1%, respectively.

Borrowings under the amended facility are secured by a pledge of substantially all of the Company's assets and bear interest at a base rate or LIBOR plus an applicable margin ranging from 1% to 4%. Available borrowings under the revolving credit facility are determined by the Company's borrowing base, which is calculated based upon eligible accounts receivable and inventories as defined in the agreement.

The amended revolving credit and term loan agreement contains certain financial covenants of the Company, including minimum net worth, minimum EBITDA, and maximum total leverage ratio, and places limitations or restrictions on various business transactions, including capital expenditures, investments, purchases of the Company's stock, dividend payments, and asset sales. The Company was in compliance with these covenants on June 27, 2003.

Historically, the Company's primary sources of liquidity have been cash provided by operations and its revolving credit agreement. The Company's liquidity position is dependent upon a number of factors, including the timing of production and delivery on sales contracts and the timing of billing and collection activity. Purchases of materials for production and payment for labor and overhead expenses can represent significant advance expenditures, and billings to and collection from customers can lag these expenditures significantly on some longer-term customer contracts. The Company's billing arrangements include (a) monthly progress payments (typically on fixed-price contracts) in which customers are billed 80% of incurred cost plus general and administrative expenses but without profit, (b) monthly billing in full at cost incurred plus profit (typically on cost-plus contracts), (c) periodic milestone achievement-based billing at cost incurred plus profit, and (d) billing at final delivery at cost incurred plus profit. Fixed-price contracts, some milestone-based contracts, and bill-at-delivery contracts represent a significant required use of working capital for the Company that must be funded by operations or through external sources.

The Company has three defined benefit pension plans covering certain of its employees. See Note 13 of Notes to Consolidated Financial Statements contained in the Company's 2002 Annual Report to Stockholders for a complete description of these plans, including details regarding fluctuations in the fair values of plan assets and the projected benefit obligations associated with these plans for

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the three years ended December 31, 2002. While the cash requirements and expenses associated with these plans were minimal during this three year period, the Company anticipates that, absent a recovery in the equity market, it may be required to make increased cash contributions to the plans in 2003 in order to meet minimum plan funding requirements, though it doesn't anticipate that such contributions will have a material impact on its consolidated cash flow for the year.

The Company's liquidity and ability to generate cash has improved significantly throughout the past year, and the Company anticipates further improvement throughout 2003 as the result of improved profitability and continuing focus on working capital management. Based upon its current level of operations and anticipated growth, the Company believes that cash from operations and other available sources of liquidity, including available borrowings under the amended revolving credit facility, will be sufficient to fund its operations for at least the next two years. The Company does not anticipate any significant nonoperating events that will require the use of cash.

The Company has contractual obligations to make future payments under its amended term loan agreement and under long-term noncancelable lease agreements. The following table sets forth these contractual obligations as of June 27, 2003.

|                        | Payments due by period |           |                 |         |
|------------------------|------------------------|-----------|-----------------|---------|
| Contractual Obligation | 2003                   | 2004-2007 | 2008 and beyond | Total   |
| (In millions)          |                        |           |                 |         |
| Term loans             | \$5.4                  | \$36.6    | \$162.4         | \$204.4 |
| Capital leases         | .1                     | .1        | ---             | .2      |
| Operating leases       | 2.5                    | 14.7      | 2.7             | 19.9    |
| Total                  | \$8.0                  | \$51.4    | \$165.1         | \$224.5 |

The Company's term loan obligations for 2008 and beyond relate to its six-year term loan, which must be paid in full by March 4, 2008. The Company may prepay any obligations under its revolving credit and term loan facility without penalty. In addition, the lenders under the facility may require prepayments from the proceeds of certain transactions, including sales of net assets, issuance of equity securities, insurance/condemnation settlements, and the reversion of surplus assets from pension plans, as well as from any excess cash flows, as defined in the agreement, generated by the Company during a fiscal year.

The Company's noncancelable operating leases are primarily for office space and manufacturing equipment. Certain of these agreements are subject to periodic escalation provisions for increases in real estate taxes and other charges.

At June 27, 2003, the Company had outstanding letters of credit of approximately \$14.7 million. These letters of credit, substantially all of which expire within a year, relate primarily to the Company's contracts with foreign governments.

Backlog

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The Company defines backlog as the value of contract awards received from customers which have not yet been recognized as sales. Funded backlog refers to contract awards for which the Company has received orders and the customer has obligated funds. Unfunded backlog consists of potential product orders relating to existing customer contracts that are the subject of customer options for additional products or potential orders under existing contracts that receive annual or incremental funding. A significant portion of the Company's sales are to prime contractors, the Department of Defense, and foreign governments pursuant to long-term contracts. Accordingly, the Company's backlog consists in large part of orders under these contracts. As of June 27, 2003, the Company's funded backlog was \$276.1 million, and its total backlog was \$759.2 million.

The following depicts the Company's backlog of orders by business segment at June 27, 2003 and December 31, 2002:

|                                       | Funded           |                      | Unfunded         |                      |
|---------------------------------------|------------------|----------------------|------------------|----------------------|
|                                       | June 27,<br>2003 | December 31,<br>2002 | June 27,<br>2003 | December 31,<br>2002 |
| (In millions)                         |                  |                      |                  |                      |
| Electronic Combat Systems             | \$139.3          | \$140.2              | \$464.8          | \$ 98.3              |
| Diagnostics & Power Systems           | 50.4             | 59.4                 | 15.8             | 17.9                 |
| Communications & Surveillance Systems | 86.4             | 86.2                 | 2.5              | .9                   |
| Total Backlog                         | \$276.1          | \$285.8              | \$483.1          | \$117.1              |

Electronic Combat Systems' unfunded backlog at June 27, 2003 includes approximately \$367.5 million of the segment's estimated 70% share of a ten year indefinite delivery, indefinite quantity contract to provide the U.S. Air Force, U.S. Navy, U.S. Marine Corps., and Air National Guard with an interoperable air combat training capability under a cooperative multi-service effort with Cubic Defense Applications.

While it is expected that a substantial portion of funded backlog will be converted to revenue during 2003, the Company cannot provide assurance that the backlog, both funded and unfunded, will become revenue in any particular period, if at all. Uncertain timing of bookings and revenue recognition is typical in the industry in which the Company conducts business.

### Seasonality

The Company's business is seasonal, with a concentration of revenue in the fourth quarter of the year, as many of the Company's sales contracts expire on December 31 of each year. As a result, product sales efforts at year end are expedited to fulfill funding terms prior to expiration of the contracts.

### Related Party Transactions

The Company pays Veritas Capital Management, L.L.C. ("Veritas") an annual management fee. Veritas controls the Company's principal

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stockholder, IDT Holding, L.L.C. The Company paid \$450,000 in management fees to Veritas in both first half 2003 and 2002. In addition, in connection with the Company's initial public offering on February 27, 2002, the Company paid a \$1.5 million transaction advisory fee to The Veritas Capital Fund, L.P. The Company was not indebted to its principal stockholder or to Veritas at June 27, 2003 or December 31, 2002. Robert B. McKeon and Thomas J. Campbell, the Chairman and Secretary of the Company, respectively, and members of its Board of Directors, are managing members of Veritas.

William G. Tobin, a member of the Company's Board of Directors and audit committee, is a Managing Director and Chairman of the Defense and Aerospace practice of Korn/Ferry International, an executive search firm. The Company contracted with Korn/Ferry in 2002 to conduct its search for a Chief Operating Officer. During 2002, the Company made payments to Korn/Ferry totaling \$179,000 in connection with this search, including \$146,000 paid in the first six months of 2002. The search was concluded in 2002, and no further payments to Korn/Ferry in connection with the search have been made.

Edward N. Ney, a member of the Company's Board of Directors and audit committee, is Chairman Emeritus of Young & Rubicam, an advertising firm for which he previously served as President and Chief Executive Officer. The Company has contracted with Burson-Marsteller, an affiliate company of Young & Rubicam, to manage its investor relations functions. During the six month periods ended June 27, 2003 and June 30, 2002, the Company made payments to Burson-Marsteller totaling approximately \$81,000 and \$145,000, respectively. On June 27, 2003, the Company owed Burson-Marsteller approximately \$27,000 for services rendered during the second quarter of 2003. This payable is included in "Other accrued expenses" in the Company's consolidated balance sheet as of that date.

### Critical Accounting Policies and Estimates

Management's Discussion and Analysis of Financial Condition and Results of Operations is based upon the Company's consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these financial statements requires management to make estimates and assumptions which affect the amounts reported in the financial statements and determine whether contingent assets and liabilities, if any, are disclosed in the financial statements. On an ongoing basis, the Company evaluates its estimates and assumptions, including those related to long-term contracts, product returns and warranty obligations, bad debts, inventories, the recoverability of goodwill and other intangible assets, fixed asset lives, income taxes, self-insurance reserves, pensions and other post-retirement benefits, environmental matters, litigation, and other contingencies. The Company bases its estimates and assumptions on historical experience and on various other factors which are believed to be reasonable under the circumstances, including current and expected economic conditions, the results of which form the basis for making judgments about the carrying values of assets and liabilities which are not readily apparent from other sources. Actual results could differ materially from the Company's estimates under different assumptions or conditions.

The Company believes the following critical accounting policies affect its more significant estimates and assumptions used in the

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preparation of its consolidated financial statements:

**Revenue Recognition.** The Company recognizes revenue and profit on approximately 80% of its contracts using the percentage-of-completion method of accounting, which relies on estimates of total expected contract revenues and costs. The Company follows this method since reasonably dependable estimates of the revenues and costs applicable to various stages of the contracts can be made. Recognized revenues and profit are subject to revisions as the projects progress to completion. Revisions to the Company's profit estimates are charged to income in the period in which the facts that give rise to the revisions become known. Although the Company makes provisions for losses on its contracts in its financial statements, it cannot provide assurance that such contract loss provisions, which are based upon estimates, will be adequate to cover all future losses or that it will not be required to restate prior period quarterly or annual financial statements as the result of errors in its estimates.

**Goodwill.** The Company has in its June 27, 2003 consolidated balance sheet a goodwill asset in the amount of \$142.1 million. In accordance with the provisions of FASB Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets ("SFAS 142"), the Company performs periodic impairment tests of its goodwill. The process of evaluating goodwill for impairment involves the determination of the fair value of the Company's business units. Inherent in such fair value determinations are certain judgments and estimates, including the interpretation of current economic indicators and market valuations, and assumptions about the Company's strategic plans with regard to its operations. To the extent additional information arises or the Company's strategies change, it is possible that the Company's conclusions regarding goodwill impairment could change and result in a material effect on its consolidated financial position or results of operations.

**Other Intangible Assets.** The Company's June 27, 2003 consolidated balance sheet contains other intangible assets totaling \$54.8 million, substantially all of which were acquired in the Signia acquisition. These intangible assets consist of trade names and trademarks, patents and proprietary technology, and customer relationships. In accordance with the provisions of FASB Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ("SFAS 144"), the Company performs periodic impairment tests of its intangible assets when events and circumstances warrant such a review. The process of evaluating intangible assets for impairment involves the estimation of their remaining useful lives and the projection of future cash flows related to the assets. Factors that may impact these estimates and projections include, among other things, the level of brand support, customer demand, governmental regulation, the ability to raise prices, maintenance of historical market share and margins, and other factors. Changes in the Company's estimates and assumptions regarding these factors could affect the Company's conclusions regarding the value of its intangible assets and result in a material effect on its financial position or results of operations.

**Inventories.** The Company reduces the value of its inventories for estimated obsolescence or unmarketable items in an amount equal to the difference between the cost of inventories and their estimated market values based upon assumptions about future demand

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and market conditions. If actual future demand or market conditions are less favorable than those projected by management, inventory write-downs may be required.

Contingencies. As discussed in its Annual Report on Form 10-K for the year ended December 31, 2002, the Company is involved in various legal actions arising in the normal course of its business, including a National Park Service investigation regarding the presence of residual radioactive materials and contamination at a uranium mine previously owned by a predecessor of one of the Company's subsidiaries. The outcomes of such legal actions are not expected, either individually or in the aggregate, to result in a material adverse effect on the Company's business, results of operations, or financial condition. It is possible, however, that future results of operations for any particular quarterly or annual period could be materially affected by changes in the Company's assumptions related to these proceedings. The Company accrues its best estimate of the probable cost for the resolution of legal claims. Such estimates are developed in consultation with outside counsel handling these matters and are based upon a combination of litigation and settlement strategies. To the extent additional information arises or the Company's strategies change, it is possible that the Company's best estimate of its liability in these matters, if any, may change.

Pension and Other Postretirement Benefits. The Company follows the guidance of FASB Statement of Financial Accounting Standards No. 87, Employers' Accounting for Pensions ("SFAS 87"), and FASB Statement of Financial Accounting Standards No. 106, Employers' Accounting for Postretirement Benefits Other Than Pensions ("SFAS 106"), when accounting for pension and postretirement benefits. Under these accounting standards, assumptions are made regarding the valuation of benefit obligations and the performance of plan assets. Delayed recognition of differences between actual results and expected or estimated results is a guiding principle of these standards. This delayed recognition of actual results allows for a smoothed recognition of changes in benefit obligations and plan performance over the working lives of the employees who benefit under the plans. The primary assumptions are as follows:

- o Discount rate - The discount rate is used in calculating the present value of benefits, which is based upon projections of benefit payments to be made in the future.
- o Expected return on plan assets - Management projects the future return on plan assets based principally upon prior performance. These projected returns reduce the net benefit costs the Company will record currently.

During 2002, the Company made changes to its assumptions related to the discount rate and the expected return on plan assets. Management consults with its actuaries when selecting each of these assumptions.

In selecting the discount rate, the Company considers fixed-income security yields, specifically AA-rated corporate bonds. At December 31, 2002, the Company decreased the discount rates used for all of its plans to 6.5% from the range of 7.0% to 7.25% used in the prior year as a result of decreased yields for long-term AA-rated corporate bonds.

In estimating the expected return on plan assets, the Company

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considers past performance and future expectations for the types of investments held by the plans as well as the expected long-term allocations of plan assets to these investments. At December 31, 2002, the Company decreased the expected return on plan assets for all of its plans to 8.5% from the range of 8.5% to 9% used in the prior year.

A variance in the assumptions described above would have an impact on the projected benefit obligations, the accrued other postretirement benefit liabilities, the annual net periodic pension and other postretirement benefit cost, and the Company's other comprehensive loss associated with its minimum pension liability adjustment.

The fair value of the Company's pension plan assets declined from \$27.3 million at December 31, 2001 to \$23.7 million at December 31, 2002 due to the payment of benefits and the decline in the equity markets. This decline will serve to increase pension expense for 2003 through the calculation of "market-related value", which recognizes changes in fair value averaged on a systematic basis over five years, but the amount of these contributions has not yet been determined.

For additional information regarding the Company's pension and postretirement plans, see Note 13 of Notes to Consolidated Financial Statements contained in the Company's 2002 Annual Report to Stockholders.

The above listing is not intended to be a comprehensive list of all of the Company's accounting policies. In many cases, the accounting treatment of a particular transaction is specifically dictated by U.S. GAAP, with no need for management's judgment of their application. There are also areas in which management's judgment in selecting an available alternative would not produce a materially different result. See the Company's audited financial statements and notes thereto contained in its 2002 Annual Report to Stockholders for a discussion of the Company's accounting policies and other disclosures required by U.S. GAAP.

### Recent Accounting Pronouncements

In fourth quarter 2002, the Company early adopted the provisions of FASB Statement of Financial Accounting Standards No. 145 ("SFAS 145"), which rescinded FASB Statement of Financial Accounting Standards No. 4, Reporting Gains and Losses from Extinguishment of Debt ("SFAS 4"), and made other technical corrections to existing authoritative pronouncements. SFAS 4 required companies to classify all gains and losses from extinguishment of debt as extraordinary items, net of the related tax effects, in their statements of operations. SFAS 145 requires gains and losses from extinguishment of debt to be classified as income or loss from continuing operations unless they meet the criteria for classification as extraordinary items contained in Accounting Principles Board Opinion No. 30. In accordance with the provisions of SFAS 145, the Company has reclassified its first quarter 2002 early debt extinguishment loss of \$13.1 million, which was previously classified as an extraordinary item, net of tax, into its loss from continuing operations. This loss is included in "Refinancing costs" in the Company's consolidated statement of operations for the six months ended June 30, 2002. See Note 2 of Notes to Consolidated Financial Statements contained in this

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quarterly report on Form 10-Q for further discussion of the Company's refinancing costs.

### Item 3: Quantitative and Qualitative Disclosures About Market Risk

The Company has experienced no material changes in its market risk exposures which would affect the quantitative and qualitative disclosures provided in its Annual Report on Form 10-K for the year ended December 31, 2002.

### Item 4: Controls and Procedures

Under the supervision and with the participation of the Company's management, including its Chief Executive Officer and Chief Financial Officer, the Company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures within 90 days of the filing date of this quarterly report on Form 10-Q. Based upon this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are adequate and effective to ensure that material information relating to the Company and its consolidated subsidiaries is made known to them by others within those entities, particularly during the period in which this quarterly report on Form 10-Q was prepared. There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

## INTEGRATED DEFENSE TECHNOLOGIES, INC. PART II. OTHER INFORMATION

### Item 4. Submission of Matters to a Vote of Security Holders

Integrated Defense Technologies, Inc. held its Annual Meeting of Stockholders on June 3, 2003. The results of the meeting were as follows.

- (1) Four Class I Directors were re-elected to the Board of Directors to serve a three-year term expiring at the 2006 Annual Meeting of Stockholders, or until their respective successors are duly elected and qualified.

|                           | Votes      |                        |                              |
|---------------------------|------------|------------------------|------------------------------|
|                           | For        | Against or<br>Withheld | Abstentions and<br>Non-Votes |
| Robert B. McKeon          | 18,778,242 | 1,366,765              | 1,182,924                    |
| General Richard E. Hawley | 20,054,312 | 90,695                 | 1,182,924                    |
| Admiral Joseph W. Prueher | 20,054,312 | 90,695                 | 1,182,924                    |
| General Anthony C. Zinni  | 20,054,212 | 90,795                 | 1,182,924                    |

- (2) Ratification of the selection by the Audit Committee of the Board of Directors of Deloitte & Touche LLP as the Company's



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independent auditor for fiscal year 2003 was approved by a vote of 19,665,026 for, 477,388 against, and 1,185,517 abstentions and non-votes.

Item 6: Exhibits and Reports on Form 8-K

(a) Exhibits

- Exhibit 31.1 Certification of the Chief Executive Officer Pursuant to Exchange Act Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- Exhibit 31.2 Certification of the Chief Financial Officer Pursuant to Exchange Act Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- Exhibit 32 Certifications 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

On July 29, 2003, the Company filed a report on Form 8-K to furnish the July 29, 2003 announcement of its earnings results for the quarter ended June 27, 2003 pursuant to Item 12. Results of Operations and Financial Condition.

INTEGRATED DEFENSE TECHNOLOGIES, INC.

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.

INTEGRATED DEFENSE TECHNOLOGIES, INC.

-----  
(Registrant)

By: /s/ Thomas J. Keenan  
-----  
Thomas J. Keenan  
Chief Executive Officer  
(Principal Executive Officer)

By: /s/ John W. Wilhoite  
-----  
John W. Wilhoite  
Vice President of Finance and  
Chief Financial Officer  
(Principal Financial and  
Accounting Officer)

Date: August 8, 2003

Date: August 8, 2003