HALIFAX CORP
Form 10-K
July 10, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K

(Mark One)

þ **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the fiscal year ended March 31, 2007 or

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from __________ to __________
Commission file Number 1-08964
Halifax Corporation
(Exact name of registrant as specified in its charter)

Virginia	**54-0829246**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
5250 Cherokee Avenue, Alexandria, VA	**22312**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code **(703) 658-2400**
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock ($.24 par value)	**American Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act: None
Indicate by check mark if the registrant is a well- known seasoned issuer, as defined in Rule 405 of the Securities Act. o Yes þ No
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. o Yes þ No
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities 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. þ Yes o No
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or non-accelerated filer See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.
o Large accelerated filer o Accelerated filer þ Non-accelerated filer
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes þ No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of September 30, 2006 was $5,686,496, computed based on the closing price for that date.
Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date.

Class	Outstanding at June 25,2007
Common Stock $0.24 par value	3,175,206

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement of the registrant for the registrant s 2007 Annual Meeting of Shareholders, which definitive proxy statement will be filed with the Securities and Exchange Commission not later than 120 days from the company s year end, are incorporated by reference into Part III of the financial report on Form 10-K. Notwithstanding such incorporation, the Compensation Committee Report shall be deemed furnished in the annual report on Form 10-K and other information in the 2007 definitive proxy statement that is not required to be included in Part III shall not be deemed to be incorporated by reference into or filed as part of this report.

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PART I

Forward- Looking Statements

Certain statements in this Annual Report on Form 10-K constitute forward-looking statements within the meaning of the Federal Private Securities Litigation Reform Act of 1995. While forward-looking statements sometimes are presented with numerical specificity, they are based on various assumptions made by management regarding future events over which we have little or no control. Forward-looking statements may be identified by words including anticipate, believe, estimate, expect and similar expressions. We caution readers that forward-looking statements, including without limitation, those relating to future business prospects, revenues, working capital, liquidity, and income, are subject to certain risks and uncertainties that would cause actual results to differ materially from those indicated in the forward-looking statements. Factors that could cause actual results to differ from forward-looking statements include the concentration of our revenues, risks involved in contracting with our customers, including the difficulty to accurately estimate costs when bidding on a contract and the occurrence of start-up costs prior to receiving revenues and contracts with fixed price provisions, potential conflicts of interest, difficulties we may have in attracting and retaining management, professional and administrative staff, fluctuation in quarterly results, our ability to generate new business, our ability to maintain an effective system of internal controls, risks related to acquisitions and our acquisition strategy, continued favorable banking relationships, the availability of capital to finance operations and planned growth and ability to make payments on outstanding indebtedness, weakened economic conditions, reduced end-user purchases relative to expectations, pricing pressures, excess and obsolete inventory, acts of terrorism, energy prices, risks related to competition and our ability to continue to perform efficiently on contracts, and other risks and factors identified from time to time in the reports we file with the SEC. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated or projected.

Forward-looking statements are intended to apply only at the time they are made. Moreover, whether or not stated in connection with a forward-looking statement, we undertake no obligation to correct or update a forward-looking statement should we later become aware that it is not likely to be achieved. If we were to update or correct a forward-looking statement, investors and others should not conclude that we will make additional updates or corrections thereafter.

All references to we, our, us, the Company, or Halifax refer, on a consolidated basis to Halifax Corporation unle otherwise indicated.

Item 1. Business

Our Business

Halifax Corporation, headquartered in Alexandria, Virginia, provides a comprehensive range of enterprise maintenance services and solutions to a broad base of clients throughout the United States. We provide 7x24x365 technology solutions that can meet stringent enterprise service requirements. We are a nation-wide, high-availability, multi-vendor enterprise maintenance services and solutions provider for enterprises, including businesses, global service providers, governmental agencies and other organizations. For more than 37 years, we have been known for quality and reliability in service delivery to our customers.

We were incorporated in 1967 under the laws of the Commonwealth of Virginia. We maintain our principal executive offices at Halifax Office Park, 5250 Cherokee Avenue, Alexandria, Virginia 22312. Our telephone number is (703) 658-2400, and our website is www.hxcorp.com. We make available free of charge on www.hxcorp.com a link to our annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as is reasonably practical after we file such material with or furnish it to the SEC s website. The information on the website listed above is not and should not be considered part of this Form10-K and is not incorporated by reference in this document. This website is and only is intended to be an inactive textual reference.

Our strategy is to build our position as an innovative leader in the high availability enterprise maintenance solutions marketplace. We currently have the following key business focuses:

- High Availability Maintenance Services- 7 days a week, 24 hours a day, 365 days a year, multi-vendor support for nationwide customers with demanding service level requirements

- Technology Deployment and Integration Services- nationwide deployment and integration support services.

On June 30, 2005, we sold our secure networks services business to enable us to focus our resources on our core business of high availability enterprise maintenance services and technology deployment and integration services.

High Availability Maintenance Services

We provide our clients with a comprehensive high availability enterprise maintenance solution through a single point of contact. Our service offerings include high availability enterprise maintenance services customized to specific customer needs for 7 days per week, 24 hours per day, 365 days per year (7x24x365) support on a nationwide basis, life cycle management of client desktop environment and equipment, moves and changes, and providing personnel with security clearances to support certain governmental agencies. Clients are offered a unique mix of nationwide coverage, multi-vendor and multi-system support, project management expertise, and customized service programs. The result is a customized solution that meets our customers enterprise maintenance requirements while reducing their costs.

We provide our maintenance services to over 25,000 locations and more than 350,000 units of equipment through a wide variety of custom designed programs. A 7x24x365 dispatch center, a state-of-the-art depot repair facility, inventory warehouses and a technical support staff supports our enterprise maintenance clients. Halifax is an authorized service provider for many major manufacturers, including International Business Machines, Hewlett Packard, Dell, Gateway and Lexmark.

Halifax works closely with each client to develop and implement the service program needed to achieve its business objectives. We draw from a wide range of services expertise and an established corporate technology base to deliver customized, results-driven enterprise maintenance solutions.

Technology Deployment and Integration Services

We provide technology deployment and integration services through several of our alliance partners and certain direct customers. At present, our principal service offering is seat management, which is a highly customizable and comprehensive service that encompasses the management, operation, and maintenance of an organization s desktops, servers, communications, printers, peripherals and associated network infrastructure and components. This service transfers complete PC desktop responsibility along with all associated services from the client to us. In return, the organization is afforded a full spectrum of computing resources for a fixed price per seat through a single ordering process.

Our seat management services provide each client with a business solution that is flexible enough to suit the unique requirements of the organization, while still offering the client absolute control over its IT environment by defining the level of service required to support the end users and the client s missions.

Our seat management services provide numerous tangible benefits that can have an immediate impact on an organization. These benefits include the ability to:

- Reduce our clients total cost of ownership;

- Improve service levels and response times;

- Reduce the administrative costs for procurement;

- Increase user productivity through decreased downtime;

- Amortize costs across thousands of users;

- Focus IT staff on core responsibilities;

Eliminate the time and expense of storage, sale, and disposal of surplus equipment;

Simplify accounting with one report, one invoice, and one charge per user; and

Create a single source of accountability for all PC desktop hardware, software, and services.

Types of Customers

The following table reflects the distribution of revenues by type of customer (see Management s Discussion and Analysis of Financial Condition and Results of Operations for further discussion):

	Years Ended March 31,					
(Amounts in thousands)	2007		2006		2005	
State/Municipal Government	$ 8,349	17%	$ 10,705	19%	$ 9,663	20%
Commercial	41,260	81%	43,383	80%	37,851	78%
Federal Government	1,086	2%	823	1%	912	2%
Total	$ 50,695	100%	$ 54,911	100%	$ 48,426	100%

We continue to work toward expanding our commercial and state/municipal government business. Commercial revenues are being pursued by targeting non-federal and IT outsourcing opportunities. State/municipal government contracts may increase as a result of privatization opportunities.

Types of Contracts

We perform services under time-and-material, fixed unit-price, subcontracts, and General Services Administration, or GSA, schedule contracts. For time-and-material contracts, we receive a fixed hourly rate intended to cover salary costs attributable to work performed on the contracts and related indirect expenses, as well as a profit margin, and reimbursement for other direct costs. Under fixed unit-price contracts, we are paid an agreed-upon price per unit for services rendered. Under fixed unit-price contracts and time-and-material contracts, we bear any risk of increased or unexpected costs that may reduce our profits or cause us to sustain losses. When we are selected under a GSA schedule contract to provide products or services, revenues are recognized upon delivery of the product or services. Presently, our sales under the GSA contract are limited to product sales, where the risks related to unexpected costs increases do not exist.

For the three years ended March 31, 2007, 2006 and 2005, approximately 90%, of our revenues received were from fixed unit-price revenues contracts.

We are sensitive to the present climate in the government with respect to fraud, waste and abuse, and have adopted a Code of Business Ethics and Standards of Conduct and associated procedures. In addition, all employees receive training in business ethics and associated procedures, and a hotline has been established to encourage reporting of potential ethical violations.

Our primary offices include locations in:

- Alexandria, Virginia;
- Harrisburg, Pennsylvania;
- Richmond, Virginia;
- Trenton, New Jersey;
- Charleston, South Carolina;
- Seattle, Washington; and
- Ft. Worth, Texas.

Accounts Receivable

Trade accounts receivable at March 31, 2007 and 2006 represented 48% and 42% of total assets, respectively. Accounts receivable are comprised of billed and unbilled receivables. Billed receivables represent invoices presented to the customer. Unbilled receivables represent revenues earned with future payments due from the customer for which invoices will not be presented until a later period.

Backlog

Our funded backlog for services as of March 31, 2007 was $69.0 million and $60.7 million at March 31, 2006. Of the $69.0 million of backlog at March 31, 2007, approximately 50% of our backlog is expected to be recognized during fiscal year 2008. Funded backlog represents commercial orders and government contracts to the extent that funds have been appropriated by and allotted to the contract by the procuring entity, some of which may span multiple years. Some of our contract orders provide for potential funding in excess of the monies initially provided by the government. Additional monies are subsequently and periodically authorized in the form of incremental funding documents. The excess of potential future funding over funding provided represents unfunded backlog. A majority of our customer orders or contract awards and extensions for contracts previously awarded are received or occur at various times during the year and may have varying periods of performance.

Sales and Marketing

Our direct sales and marketing organization is focused on delivering additional services and solutions to our targeted markets and current client base. Our marketing efforts have focused on increasing brand awareness, enhancing bid and proposal capabilities, producing targeted sales aids, identifying high potential sales leads, and engaging in other public relations activities.

We deliver services and solutions through a variety of distribution channels. We have developed strong partnership alliances with certain global services providers, OEM s and system integrators. We have also developed several direct relationships with commercial, federal, state and local customers.

Competition

We have numerous competitors in our marketplace. Some competitors are large diversified firms having substantially greater financial resources and a larger technical staff than ours, including, in some cases, the manufacturers of the systems being supported, and others are small companies within a regional market or market niche. Customer in-house capabilities can also create competition in that they perform certain services which might otherwise be performed by us. It is not possible to predict the extent of competition which our present or future activities will encounter because of changing competitive conditions, customer requirements, technological developments and other factors. The principal competitive factors for the type of service business in which we are engaged are technology skills, quality, pricing, responsiveness and the ability to perform within estimated time and expense guidelines.

We believe we are most competitive where the customer is geographically dispersed throughout the U.S. and demands high service attainment levels.

Personnel

On March 31, 2007, we had 517 employees, of whom 55 were part-time and 40 were temporary employees. Because of the nature of our services, many employees are professional or technical personnel with high levels of training and skills, including engineers, skilled technicians and mechanics. We believe our employee relations are excellent. Although many of our personnel are highly specialized, we have not experienced material difficulties obtaining the personnel required to perform under our contracts and generally do not bid on contracts where difficulty may be encountered in providing these necessary services. Management believes that the future growth and our success will depend, in part, upon our continued ability to retain and attract highly qualified personnel.

Executive Officers of the Registrant

The key executive officers of the Company, who are not also directors, other than Mr. McNew, are:

Charles L. McNew, age fifty-five, is our President and Chief Executive Officer. Mr. McNew has held this position since May 2000. Mr. McNew became a director in 2000. He served as our acting President and Chief Executive Officer from April 2000 to May 2000 and prior to that was our Executive Vice President and Chief Financial Officer from July 1999 until April 2000. Mr. McNew has over 25 years of progressive management experience and has held senior level management positions with a variety of public telecommunications and services companies. Prior to joining the Company, from July 1994 through July 1999, Mr. McNew was Chief Financial Officer and then Chief Operating Officer of Numerex Corporation, a publicly traded wireless telecommunications solutions company. Mr. McNew has a Master Degree in Business Administration from Drexel University and a Bachelor of Science Degree in accounting from Penn State.

Joseph Sciacca, age fifty-four, is our Vice President of Finance and Chief Financial Officer. Mr. Sciacca has been Vice President of Finance and Chief Financial Officer since May 2000. He was appointed Corporate Controller in December 1999 and provided consulting services to us prior thereto beginning in March 1999. From September 1996 through September 1998, he was Chief Financial Officer of On-Site Sourcing, a legal document management services firm. From 1994 through 1996, he was a principal in a tax and consulting firm. Mr. Sciacca has a Masters Degree in Taxation from American University and a Bachelor of Science Degree in Business Administration from Georgetown University.

Hugh Foley, age fifty-five, is our Vice President of Operations. As Vice President of Operations, a position held since April 2002, Mr. Foley manages the service delivery operations for our seat management program, staff augmentation services, as well as IT professional services and product offerings. Mr. Foley joined us in November 1998, initially to manage and implement the Virginia Department of Transportation / Virginia Retirement Systems seat management contract. Prior to joining us, Mr. Foley spent 16 years in the computer service industry in various sales, operations and financial management positions with Sorbus, Bell Atlantic Business Systems, and DecisionOne. Mr. Foley has a Master Degree in Business Administration from Drexel University and a Bachelor of Science Degree in Business Administration from Villanova University.

Douglas H. Reece, age thirty-seven, is our Vice President of Sales. Mr. Reece has been with us since November 2001 as Director of Sales and Marketing, and was promoted to Vice President of Sales on April 3, 2006. From October 1999 through November 2001, Mr. Reece worked for Veritas Corporation, a software company, and from August 1999 through September 1999, he was employed by Ernst & Young, LLP where he held various service, sales and operating positions. Mr. Reece has a Master Degree in International Transactions from George Mason University and a Bachelor of Arts in Political Science Degree from West Virginia University.

Item 1A Risk Factors

Investing in our common stock involves risks. You should carefully consider all of the information contained in this Annual Report on Form 10-K and, in particular, the risks described below. Additional risks and uncertainties not presently known to us or those we currently deem immaterial may impair our business operations in the future. If any of the following risks actually occur, our business, financial condition or results of operations could be materially harmed and you may lose part or all of your investment.

We experienced losses from continuing operations in fiscal 2007 and 2006, and continued losses may negatively impact our financial position and value of our common stock.

We incurred a losses from continuing operations in fiscal 2007 of $2.8 million and a loss from continuing operations of $1.3 million in fiscal year 2006. The primary reasons for the loss from continuing operations in fiscal 2007 were losses associated with an equipment roll out project in the fourth quarter, an accounting charge for inventory obsolescence, and an accounting charge as the result of the establishment of a 100% valuation reserve against our deferred tax asset. As we focus on our core business, there are no assurances that our cost containment efforts will be successful in curbing expenses or that we will be able to accurately estimate start-up costs and expenses associated with new contracts. If we incur expenses at a greater pace than our revenues, we could incur additional losses. If we continue to experience losses, our financial position could be negatively impacted and the value of our common stock may decline.

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Our revenues are derived from a few major customers, the loss of any of which could cause our results of operations to be adversely affected.

We have a number of major customers. Our largest customer accounted for 29%, 20%, and 20% of our revenues for the fiscal years ended March 31, 2007, 2006 and 2005, respectively. Through the aggregation of multiple contracts, our largest customer during fiscal year ended March 31, 2007 was IBM. Our five largest customers collectively accounted for 60%, 54% and 65% of revenues for the fiscal years ended March 31, 2007, 2006 and 2005, respectively. We anticipate that significant customer concentration will continue for the foreseeable future, although the companies which constitute our largest customers may change from period to period. Factors beyond our control, including political, state and federal budget issues, competitor prices and other factors may have an impact on our ability to retain contracts. The loss of any one or more of these customers may adversely affect our results.

If we experience a decline in cash flow or are unable to maintain compliance with the covenants contained in our revolving credit facility, our ability to operate could be adversely affected.

If either cash flow from operations declines or borrowings under our revolving credit agreement are insufficient to meet our needs, our ability to operate could be adversely affected. In addition, the loss of a significant contract, adverse economic conditions or other adverse circumstances may cause our capital resources to change dramatically. Operating results may also be negatively affected due to costs associated with starting a major contract. Many costs associated with starting a new contract, such as hiring additional personnel, training, travel and logistics are expensed as incurred and may also significantly impact cash flow during the startup period. Additional funds, if needed, to help fund start-up costs related to a major new contract may not be available. We view our revolving credit facility as a critical source of available liquidity. This facility contains various conditions, covenants and representations with which we must be in compliance in order to borrow funds. We were not in compliance with the terms of our revolving credit facility at March 31, 2007. We requested and obtained a waiver from our bank for the non-compliance with the financial covenants as of March 31, 2007 and June 30, 2007. There is no assurance that we will remain in compliance with the conditions, covenants and representations contained in the revolving credit agreement or that the bank will continue to grant waivers for non-compliance. The maturity of our revolving credit agreement is June 30, 2008. Although we believe our relationship with our lender is satisfactory and we have requested and received waivers in the past for non-compliance with the financial covenants of our revolving credit agreement, there are no assurances that the lender will waive these covenants should we experience non-compliance in the future. We are in process of the completing the review of alternative sources of financing, which may replace our existing credit facilities if we are unable to comply with our financial covenants in the future.

We operate in a highly competitive market. If we are unable to offer competitive products and services, our business may be adversely affected.

We have numerous competitors in our marketplace. Some competitors are large diversified firms having substantially greater financial resources and a larger technical staff than us, including, in some cases, the manufacturers of the systems being supported, and others are small companies within a regional market or market niche. Customer in-house capabilities can also create competition in that they perform certain services which might otherwise be performed by us. It is not possible to predict the extent of competition which our present or future activities will encounter because of changing competitive conditions, customer requirements, technological developments and other factors.

The industry in which we operate has been characterized by rapid technological advances that have resulted in frequent introductions of new products, product enhancements and aggressive pricing practices, which also impacts pricing of service activities. We continue to see significant price competition and customer demand for higher service attainment levels. In addition, there is significant price competition in the market for state and local government contracts as a result of budget issues, political pressure and other factors beyond our control. As experienced with losses of some of our contracts, high quality and longevity of service may have little influence in the customer decision making process. Also, our operating results could be adversely impacted should we be unable to achieve the revenues growth necessary to provide profitable operating margins in various operations.

Our operating results may be adversely affected because of pricing pressures brought about by competition, proprietary technology that we are unable to support, presence of competitors with greater financial and other

resources or other factors beyond our control.

Our revenues and results of operations may vary period to period, which may cause the common stock price to fluctuate.

Our quarterly and annual revenues and results of operations may vary significantly in the future due to a number of factors, which could cause the common stock price to fluctuate greatly. Factors that may affect our quarterly and annual results include but are not limited to:

- changes in economic conditions;
- disruptions or downturns in general economic activity resulting from terrorist activity and armed conflict;
- competitive pricing pressure;
- lengthening sales cycles;
- obsolescence of technology;
- increases in prices of components used to support our enterprise maintenance solutions;
- loss of material contracts; and
- the success of our business strategy in providing improved operating results.

Unfavorable economic conditions, increases in reserves for inventory obsolescence and additional costs associated with an equipment roll out contract in the forth quarter have adversely affected our results of operations and led to a decline in our growth rates. We incurred a loss of $2.8 million for the fiscal year ended March 31, 2007, which also included a charge to increases in our reserve for inventory obsolescence and a charge to provide a100% valuation reserve on our deferred tax asset.

Our business was also negatively affected by the economic slowdown and reductions in spending by our customers in 2007 and 2006. The rate at which the portions of our industry improve is critical to our overall performance.

Many of our services are sold as part of a larger technology outsourcing solution. In the past, we have experienced historical growth in our business as we have assumed responsibility for maintaining our customers IT infrastructure. The demand for these services has been adversely affected by the effects of a weakened economy in recent periods with many businesses focusing on cost containment strategies and eliminating or curtailing maintenance.

We depend on recurring long-term contracts for services from a limited number of large original equipment manufacturers, or OEMs, partners and end users. Our agreements with OEMs are in the form of master service agreements and are typically cancelable, non-exclusive and have no minimum purchase requirements.

Factors beyond our control, including political, state and federal budget issues, price and other factors may have an impact on our ability to successfully retain contracts.

If we are unable to generate sufficient revenues, we may have to further down size.

For fiscal years ended March 31, 2006 and 2007, revenues decreased from $54.9 million to $50.7 million. Gross margin was $4.4 million and $3.7 million for fiscal years 2007 and 2006, respectively. If we are unable to generate sufficient new business to replace the secure networks business sold in June 2005, we may be forced to consolidate our operations to reduce operating expenses sufficiently to achieve profitable operations. There can be no assurances that we will be able to generate sufficient new business or that our cost containment measures in place will provide us the ability to attain profits in the future.

If we are unable to retain and attract highly qualified personnel to fulfill our contract obligations, our business may be harmed.

Our most important resource is our employees. Although many of our personnel are highly specialized, we have not experienced material difficulties obtaining the personnel required to perform under our contracts and generally do not bid on contracts where difficulty may be encountered in providing these necessary services. However, there can be no assurance that we will not experience difficulties in the future obtaining the personnel necessary to fulfill our obligations under our contracts.

We are subject to risks related to fluctuations in interest rates.

We are exposed to changes in interest rates, primarily as a result of using borrowed funds to finance our business. The floating interest debt exposes us to interest rate risk, with the primary interest rate exposure resulting from changes in the prime rate. Adverse changes in the interest rates or our inability to refinance our long-term obligations may have a material negative impact on our results of operations and financial condition.

We incur significant costs in connection with the start-up of new contracts before receiving related revenues, which could result in cash shortfalls and fluctuations in quarterly results from period to period.

When we are awarded a contract to provide services, we may incur expenses before we receive any contract payments. These expenses include purchasing equipment and hiring personnel. For example, contracts may not fund program start-up costs and we may be required to invest significant sums of money before receiving related contract payments. Additionally, any resulting cash shortfall could be exacerbated if we fail to either invoice the customer or to collect fees in a timely manner. A cash shortfall could result in significant consequences. For example, it:

- could increase our vulnerability to general adverse economic and industry conditions;

- will require us to dedicate a substantial portion of our cash flow from operations to service payments on our indebtedness; reducing the availability of our cash flow to fund future capital expenditures, working capital, execution of our growth strategy, research and development costs and other general corporate requirements;

- could limit our flexibility in planning for, or reacting to, changes in our business and industry, which may place us at a competitive disadvantage compared with competitors; and

- could limit our ability to borrow additional funds, even when necessary to maintain adequate liquidity.

As a result, there are no assurances that additional funds, if needed, to help fund start-up costs related to a major new contract would be available or, if available, on terms advantageous to us.

Some of our contracts contain fixed-price provisions that could result in decreased profits if we fail to accurately estimate our costs.

Some of our contracts contain pricing provisions that require the payment of a set fee by the customer for our services regardless of the costs we incur in performing these services. In such situations, we are exposed to the risk that it will incur significant unforeseen costs in performing the contract. Therefore, the financial success of a fixed-price contract is dependent upon the accuracy of our cost estimates made during contract negotiations. Prior to bidding on a fixed-price contract, we attempt to factor in variables including equipment costs, labor and related expenses over the term of the contract. However, it is difficult to predict future costs, especially for contract terms that range from 3 to 5 years. Any shortfalls resulting from the risks associated with fixed-price contracts will reduce our working capital and profitability. Our inability to accurately estimate the cost of providing services under these contracts could have an adverse effect on our profitability and cash flows.

If we are unable to effectively and efficiently manage our costs, our results of operations may be adversely affected.

We have taken, and continue to take, cost reduction actions. Our ability to complete these actions and the impact of such actions on our business may be limited by a variety of factors. The cost reduction actions may in turn expose us to additional service delivery risks and have an adverse impact on our sales and profitability. We have been reducing costs and streamlining our business process throughout our organization. We have reduced our physical facilities, reduced our employee population, improved our repair facilities, and reduced other costs. The impact of these cost-reduction actions on our revenues and profitability may be influenced by factors including, but not limited to:

- our ability to complete these on-going efforts,
- our ability to generate the level of savings we expect and/or that are necessary to enable us to effectively compete,
- decrease in employee personnel,
- ability to generate sufficient revenue and or reduce operating expenses to offset the contribution that was generated from the secure network services business which was sold on June 30, 2005, and
- the performance of other parties under arrangements on which we rely to support parts or components.

If we fail to maintain an effective system of internal controls over financial reporting, we may not be able to accurately report our financial results or prevent fraud. As a result, current and potential stockholders and customers could lose confidence in our financial reporting, which could harm our business, the trading price of our stock and our ability to retain our current customers or obtain new customers.

We are in the process of evaluating our internal controls over financial reporting in order to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act, which requires annual management assessments of the effectiveness of our internal controls over financial reporting and a report by our independent auditors on the effectiveness of our internal controls beginning with the fiscal years ending March 31, 2008 and 2009, respectively. In this regard, management will be required to dedicate internal resources to (i) assess and document the adequacy of internal controls over financial reporting, and (ii) take steps to improve control processes, where appropriate. If we fail to correct any issues in the design or operating effectiveness of internal control over financial reporting or fail to prevent fraud, current and potential stockholders and customers could lose confidence in our financial reporting, which could harm our business, the trading price of our stock and our ability to retain our current customers and obtain new customers.

If we make future acquisitions of companies, technology and other assets that involve numerous risks such as difficulty integrating acquired companies, technologies and assets or generating an acceptable return on our investments.

We may pursue opportunities to acquire companies, technologies and assets that would complement our current service offerings, expand the breadth of our markets, enhance our technical capabilities, or that may otherwise offer growth opportunities as we have done in the past. Acquisitions involve numerous risks, including the following:

- difficulties in integrating the operations, technologies, products and personnel of the acquired companies;
- diversion of management s attention from normal daily operations of our business;
- difficulties in entering markets in which we have no or limited direct prior experience and where competitors in such markets have stronger market positions;
- initial dependence on unfamiliar supply chains or relatively small supply partners;
- insufficient revenues to offset increased expenses associated with acquisitions; and

the potential loss of key employees of the acquired companies.

Acquisitions may also cause us to:

- issue common stock or preferred stock or assume stock option plans that would dilute current shareholders percentage ownership;
- use cash, which may result in a reduction of our liquidity;
- assume liabilities;
- record goodwill and other intangible assets that would be subject to impairment testing and potential periodic impairment charges;
- incur amortization expenses related to certain intangible assets;
- incur large and immediate write-offs; and
- become subject to litigation.

Mergers and acquisitions of companies in our industry and related industries are inherently risky, and no assurance can be given that our acquisition strategy will be successful, that we will have the resources to pursue this strategy, and will not materially adversely affect our business, operating results, or financial condition. Failure to manage and successfully integrate acquisitions could harm our business and operating results in a material way. Even when an acquired company has already developed and marketed products or services, there can be no assurance that product enhancements will be made in a timely fashion or that all pre-acquisition due diligence will have identified all possible issues that might arise with respect to such products or services.

The Company has capitalized certain fees related to mergers and acquisitions. These fees include costs directly related to acquisition activity primarily investment banker retainers of approximately $152,000, which is recorded as a prepaid expense on our balance sheet at March 31, 2007. These costs will be included in the cost of the acquired entity. The Company periodically reviews the status of its acquisition activity and upon determining that is not likely successful an acquisition will occur it would expense this amount to operating expense.

We have capitalized certain fees related to mergers and acquisitions. These fees include costs directly related to acquisition activity primarily investment advisory services of approximately $152,000, which is recorded as a prepaid expense on our balance sheet at March 31, 2007. These costs will be included in the cost of the acquired entity. Should we not be successful in finalizing an acquisition, this would have a negative impact on our results of operations, as we would expense this amount to operating expense.

We do not expect to pay dividends on our common stock.

We have not declared or paid any dividends on our common stock during fiscal 2007, fiscal 2006 or fiscal 2005 and do not anticipate paying any cash dividends on our common stock in the foreseeable future. Our revolving credit agreement currently prohibits the payment of dividends.

Shareholders of our common stock may face a lack of liquidity.

Although our common stock is currently traded on the American Stock Exchange, given the fact that our common stock is thinly traded, there can be no assurance that the desirable characteristics of an active trading market for such securities will ever develop or be maintained. Therefore, each investor s ability to control the timing of the liquidation of the investment in our common stock will be restricted and an investor may be required to retain investment in our common stock indefinitely.

The market price of our common stock has been and is likely to continue to be volatile, which may make it difficult for shareholders to resell common stock when they want to and at prices they find attractive.

Our share price has been volatile due, in part, to the general volatile securities market. Factors other than our operating results may affect our share price, including the level of perceived growth of the industries in which we participate, market expectations of our performance success of the partners, and the sale or purchase of large amounts of our common stock.

Provisions in our corporate charter documents could delay or prevent a change in control.

Our Articles of Incorporation, as amended, and Bylaws contain certain provisions that would make a takeover of our company more difficult. Under our Articles of Incorporation, as amended, we have authorized 1,500,000 shares of preferred stock, which the Board of Directors may issue with terms, rights, preferences and designations as the Board of Directors may determine and without the vote of shareholders, unless otherwise required by law. Currently, there are no shares of preferred stock issued and outstanding. Issuing the preferred stock, depending on the rights, preferences and designations set by the Board of Directors, may delay, deter, or prevent a change in control of us. Issuing additional shares of common stock could result in a dilution of the voting power of the current holders of the common stock. This may tend to perpetuate existing management and place it in a better position to resist changes that the shareholders may want to make if dissatisfied with the conduct of our business.

Item 1B. Unresolved Staff Comments

Not applicable

Item 2. Properties

As of March 31, 2007, we had obligations under 16 short-term facility leases associated with our operations. Total rent expense under existing leases was $1.1 million, $1.3 million, and $1.1 million for the years ended March 31, 2007, 2006 and 2005, respectively. See Note 13 to the Consolidated Financial Statements. Our executive offices are located in Alexandria, VA; with additional locations in Harrisburg, PA; Richmond, VA; Trenton, NJ; Charleston, SC; Ft. Worth, TX, and Seattle, WA.

On November 6, 1997, we sold our headquarters office complex for $5.25 million and leased back the building. The transaction generated other income of $1.49 million of which $715,000 was deferred and is being amortized over the 12 year lease-back of our headquarters building. The monthly rent is approximately $50,000.

Item 3. Legal Proceedings

On June 30, 2005, we simultaneously entered into and closed on an asset purchase agreement (the Agreement) with INDUS Corporation (Indus), pursuant to which we sold substantially all of the assets and certain liabilities of our secure network business. The purchase price was approximately $12.5 million, subject to adjustments as provided in the Agreement, based on the net assets of the business on the closing date. The Agreement also provided that $3.0 million of the purchase price was held in escrow (the Escrow). The terms of the Agreement, including the Escrow, are as set forth in the Form 8-K filed with the SEC on July 1, 2005, as amended by our Form 8-K/A filed with the SEC on July 7, 2005.

Pursuant to the Escrow, on July 8, 2005, we received $1,000,000 and on January 26, 2006, we received $1,375,000. On or about December 31, 2006, an additional $625,000 from escrow, which was being held as security in escrow for our indemnification obligations under the Agreement, was to be disbursed to us. However, on December 28, 2006, we received a Notice of Claim from Indus, pursuant to which Indus alleged various breaches of certain representations and warranties in the Agreement by us. Indus takes the position that these alleged breaches entitle Indus to indemnification. As a result, Indus further takes the position that the entire amount remaining in Escrow which totaled $625,000 plus interest of approximately $48,000, should be disbursed to Indus. The total amount of $673,000 held in escrow is recorded as restricted cash on the accompanying financial statements. We delivered a Response Notice to the escrow agent and Indus disputing the claims of Indus set forth in its Notice of Claim. We believe the claim is without merit. On June 26, 2007 we filed a complaint against Indus in the Virginia Circuit Court requesting a declaratory judgment, and other relief, including a demand that Indus withdraw its claim and disburse the funds held in escrow. No adjustment to the accompanying financial statements has been made related to this matter.

From time to time, we are engaged in ordinary routine litigation incidental to our business to which we are a party. While we cannot predict the ultimate outcome of these matters, or other routine litigation matters, it is management s opinion that the resolution of these matters should not have a material effect on our financial position or results of operations.

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

None.

PART II

Item 5. <u>Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>

Our common stock, par value $0.24, is listed on the American Stock Exchange under the symbol HX .

At June 20, 2007, there were approximately 253 holders of record of our common stock as reported by our transfer agent and approximately 384 beneficial holders.

The following table sets forth the quarterly range of high and low sales prices as reported by the American Stock Exchange for the last two fiscal years.

	Fiscal Year 2007		Fiscal Year 2006	
Fiscal Quarter	High	Low	High	Low
April - June	$3.25	$2.39	$4.39	$3.60
July - Sept.	3.00	2.30	4.31	3.40
Oct. - Dec.	3.05	2.25	3.85	2.95
Jan. - March	3.30	2.50	3.50	2.90

On June 22, 2007, the closing price of our common stock on the American Stock Exchange was $3.00.

We did not declare a cash dividend in either fiscal year 2007 or 2006, and there is no assurance we will do so in future periods. Our revolving credit loan agreement prohibits the payment of dividends and limits payment of principal or interest on our subordinated debt without a waiver from the bank. As a Virginia corporation, we may not declare and pay dividends on capital stock, if after giving effect to a dividend our total assets would be less than the sum of our total liabilities or we would not be able to pay our debts when due in the usual course of business. We currently expect to retain our future earnings for use in the operation and expansion of our business and do not anticipate paying any cash dividend in the future.

See Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters in this form 10-K for disclosure regarding our equity compensation plan information.

The graph below matches Halifax Corporation s cumulative 5-year total shareholder return on common stock with the cumulative total returns of the S & P 500 index and the S & P Information Technology index. The graph tracks the performance of a $100 investment in our common stock and in each of the indexes (with the reinvestment of all dividends) from 3/31/2002 to 3/31/2007.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

Among Halifax Corporation, The S & P 500 Index
And The S & P Information Technology Index

* $100 invested on 3/31/02 in stock or index-including reinvestment of dividends. Fiscal year ending March 31.
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www.researchdatagroup.com/S&P.htm

	3/02	3/03	3/04	3/05	3/06	3/07
Halifax Corporation	**100.00**	**78.95**	**115.00**	**109.74**	**80.26**	**80.26**
S & P 500	**100.00**	**75.24**	**101.66**	**108.47**	**121.19**	**135.52**
S & P Information Technology	**100.00**	**67.34**	**97.01**	**94.60**	**107.39**	**110.72**

The stock price performance included in this graph is not necessarily indicative of future stock price performance.

Item 6. Selected Financial Data

The following table includes selected financial data of Halifax. Our company s selected consolidated financial information set forth below should be read in conjunction with the more detailed consolidated financial statements, including the related notes, and Management s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this document.

	Years Ended March 31,				
(Amounts in thousands, except share data)	2007[1][2]	2006[1]	2005[1][3]	2004[2][3]	2003[1]
Revenues	$ 50,695	$ 54,911	$ 48,426	$ 40,056	$ 38,974
(Loss) income from continuing operations	(2,790)	(1,276)	(2,789)	3,493	(122)
Discontinued operations		310	1,378	735	770
Gain on sale of discontinued operations		2,502			
Net (loss) income	$ (2,790)	$ 1,536	$ (1,411)	$ 4,228	$ 648
Income(loss) per common share basic					
Continuing operations	$ (.88)	$ (.40)	$ (.92)	$ 1.32	$ (.05)
Discontinued operations		.09	.46	.28	.35
Gain on sale of discontinued operations		.79			
	$ (.88)	$ .48	$ (.46)	$ 1.60	$ .30
Income (loss) per common share diluted					
Continuing operations	$ (.88)	$ (.40)	$ (.92)	$ 1.27	$ (.05)
Discontinued operations		.09	.46	.27	.35
Gain on sale of discontinued operations		.79			