DRS TECHNOLOGIES INC
Form 10-Q
November 14, 2001

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

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2001

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

FOR THE TRANSITION PERIOD FROM __________ TO __________

COMMISSION FILE NUMBER 1-8533

DRS TECHNOLOGIES, INC.

DELAWARE	13-2632319
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

5 SYLVAN WAY, PARSIPPANY, NEW JERSEY 07054
(973) 898-1500

INDICATE BY CHECK MARK WHETHER THE REGISTRANT (1) HAS FILED ALL REPORTS REQUIRED TO BE FILED BY SECTION 13 OR 15(D) OF THE SECURITIES AND EXCHANGE ACT OF 1934 DURING THE PRECEDING 12 MONTHS (OR FOR SUCH SHORTER PERIOD THAT THE REGISTRANT WAS REQUIRED TO FILE SUCH REPORTS), AND (2) HAS BEEN SUBJECT TO SUCH FILING REQUIREMENTS FOR THE PAST 90 DAYS.

YES |X| NO |_|

As of November 9, 2001, 12,198,610 shares of DRS Technologies, Inc. Common Stock, $.01 par value, were outstanding.

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

INDEX TO QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2001

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE DATA)

	(UNAUDITED) SEPTEMBER 30, 2001
ASSETS	
Current assets:	
Cash and cash equivalents	$ 4,162
Accounts receivable, net	102,069
Inventories, net of progress payments	110,906
Prepaid expenses and other current assets	12,426
Total current assets	229,563
Property, plant and equipment, less accumulated depreciation and amortization of $43,667 and $39,142 at September 30, 2001 and March 31, 2001, respectively	51,531
Goodwill, less accumulated amortization of $13,754 at March 31, 2001	76,206

Acquired intangible assets, less accumulated amortization of $5,911 and $7,551 at September 30, 2001 and March 31, 2001, respectively	21,144
Purchase price in excess of net tangible assets acquired	30,054
Deferred income taxes and other noncurrent assets	10,843
	$ 419,341

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:	
Current installments of long-term debt	$ 1,436
Short-term bank debt	1,312
Accounts payable	27,460
Accrued expenses and other current liabilities	100,631
Total current liabilities	130,839
Long-term debt, excluding current installments	159,784
Other noncurrent liabilities	6,663
Total liabilities	297,286
Stockholders' equity:	
Preferred Stock, no par value. Authorized 2,000,000 shares; no shares issued at September 30, 2001 and March 31, 2001	--
Common Stock, $.01 par value per share Authorized 30,000,000 shares; issued 12,189,335 and 12,058,057 shares at September 30, 2001 and March 31, 2001, respectively	122
Additional paid-in capital	73,695
Retained earnings	52,406
Accumulated other comprehensive losses	(3,960)
Unamortized stock compensation	(208)
Net stockholders' equity	122,055
Commitments and contingencies	
	$ 419,341

See accompanying Notes to Condensed Consolidated Financial Statements

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DRS TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
(IN THOUSANDS, EXCEPT PER SHARE DATA)

(UNAUDITED)

THREE MONTHS ENDED SEPTEMBER 30, SIX MONTHS END

	2001	2000	2001
Revenues	$ 116,178	$ 107,227	$ 219,530
Costs and expenses	105,475	98,724	199,143
Operating income	10,703	8,503	20,387
Other expense (income), net	38	32	(15)
Interest and related expenses	1,838	3,537	3,963
Earnings before minority interests and income taxes	8,827	4,934	16,439
Minority interests	368	270	626
Earnings before income taxes	8,459	4,664	15,813
Income taxes	3,976	2,425	7,432
Net earnings	$ 4,483	$ 2,239	$ 8,381
Earnings per share of common stock			
Basic earnings per share:	$ 0.37	$ 0.22	$ 0.69
Diluted earnings per share:	$ 0.34	$ 0.20	$ 0.64

See accompanying Notes to Condensed Consolidated Financial Statements

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DRS TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)

(UNAUDITED)

	SIX M 2001
Cash flows from operating activities:	
Net earnings	$ 8,
Adjustments to reconcile net earnings to cash flows from operating activities:	
Depreciation and amortization	5,
Other, net	(
Changes in assets and liabilities, net of effects from business combinations:	

Decrease in accounts receivable	19,
Increase in inventories	(15,
(Increase) decrease in prepaid expenses and other current assets	(3,
Decrease in accounts payable	(12,
(Decrease) increase in accrued costs on acquired contracts	(2,
Increase (decrease) in accrued expenses and other current liabilities	3,
Increase (decrease) in customer advances	4,
Other, net	(3,
Net cash provided by operating activities	3,
Cash flows from investing activities:	
Capital expenditures	(7,
Payments pursuant to business combinations, net of cash acquired	(71,
Proceeds from sale of discontinued operations	
Other, net	
Net cash used in investing activities	(79,
Cash flows from financing activities:	
Net borrowings of short-term debt	
Retirement of long-term debt	(88,
Net payments on long-term debt	(42,
Additional borrowings of long-term debt	209,
Deferred financing fees	(4,
Other, net	1,
Net cash provided by financing activities	76,
Effect of exchange rates on cash and cash equivalents	
Net increase in cash and cash equivalents	1,
Cash and cash equivalents, beginning of period	2,
Cash and cash equivalents, end of period	$ 4,

See accompanying Notes to Condensed Consolidated Financial Statements.

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DRS TECHNOLOGIES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. BASIS OF PRESENTATION

The accompanying unaudited Condensed Consolidated Financial Statements of DRS Technologies, Inc. and Subsidiaries (DRS or the Company) have been prepared in accordance with accounting principles generally accepted in the United States and with the instructions to Form 10-Q and Article 10 of Regulation S-X. The

Company has continued to follow the accounting policies set forth in the consolidated financial statements included in its fiscal 2001 Annual Report on Form 10-K filed with the Securities and Exchange Commission, except for the April 1, 2001 adoption of the provisions of Statement of Financial Accounting Standards (SFAS) Nos. 133, "Accounting for Derivative Instruments and Hedging Activities" (see Note 7 of Notes to Condensed Consolidated Financial Statements), 141, "Business Combinations", and 142, "Goodwill and Other Intangible Assets" (see Note 4 of Notes to Condensed Consolidated Financial Statements). In the opinion of management, the interim financial information provided herein reflects all adjustments (consisting of normal and recurring adjustments) necessary for a fair presentation of the Company's consolidated financial position as of September 30, 2001, the results of operations for the three- and six-month periods ended September 30, 2001 and 2000, and cash flows for the six-month periods ended September 30, 2001 and 2000. The results of operations for the three- and six-months ended September 30, 2001 are not necessarily indicative of the results to be expected for the full year.

For further information, these interim financial statements should be read in conjunction with the Consolidated Financial Statements of the Company for the fiscal year ended March 31, 2001, included in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2001.

2. BUSINESS COMBINATIONS

On September 28, 2001, DRS acquired certain assets and liabilities of the Sensors and Electronic Systems (SES) business of The Boeing Company (Boeing) (the Acquisition). The Company paid approximately $67.1 million in cash, subject to adjustment, for the Acquisition. In addition to the purchase price, the estimated costs related to the Acquisition, including professional fees, will be approximately $4.0 million. SES, located in Anaheim, California, is a leading provider of advanced electro-optical airborne and naval surveillance and targeting systems, high-performance military infrared cooled sensor systems, and infrared uncooled sensor products for military and commercial applications. This acquisition broadens the Company's product lines and customer base of its Electro-Optical Systems Group, particularly in those areas associated with naval and air-based applications, and provides a strong complement to DRS' existing products in ground-based Forward Looking Infrared technology. SES is now operating as DRS Sensors & Targeting Systems, Inc., a unit of the Company's Electro-Optical Systems Group. The SES assets acquired and liabilities assumed have been included in our consolidated financial statements as of the date of acquisition.

The Company is in the process of obtaining a third-party valuation of the assets acquired and the liabilities assumed as well as performing its own internal assessment, thus, the allocation of the purchase price is subject to adjustment. In addition, in connection with the Acquisition the Company may incur costs associated with exiting certain activities, including severance costs. It is management's expectation that a certain amount of the purchase price will be allocated to acquired identifiable intangible assets, with such assets requiring amortization. As the the Company is unable to estimate the amount of acquired identifiable intangibles at this time, the entire excess of purchase price over the tangible net assets acquired has been included as a separate line item on the balance sheet as of September 30, 2001. In addition, since the Acquisition was completed at the end of the second quarter, there is no amortization expense related to the Acquisition in the results of operations. The purchase price allocation will be adjusted during in the second half of fiscal 2002.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

The following unaudited pro forma financial information shows the results of operations for the three- and six-month periods ended September 30, 2001 and 2000, as though the Acquisition had occurred on April 1, 2000. For purposes of the pro forma financial information shown below, DRS' operating results for the three- and six-month periods ended September 30, have been combined with SES' calendar year operating results for the three- and six-month periods ended June 30. In addition to combining the historical results of operations of the businesses, the pro forma calculations include adjustments for additional interest expense on the debt associated with the Acquisition, and the provision for income taxes for the increase in interest expense and the SES business pre-tax earnings. As indicated above, the Company is in the process of obtaining a third-party valuation of the assets acquired and the liabilities assumed as well as performing its own internal assessment, and as a result, is unable at this time to estimate the amount of acquired intangibles, therefore, there is no amortization expense included in the pro forma financial information shown below. For each $1.0 million allocated to acquired identifiable intangible assets, with an estimated ten year useful life, amortization expense would increase by $100,000.

	(IN THOUSANDS EXCEPT PER SHARE DATA		
	THREE MONTHS ENDED SEPTEMBER 30,		SIX MONTHS END
	2001	2000	2001
Revenues	$ 142,169	$ 126,597	$ 272,115
Net earnings	$ 4,484	$ 1,085	$ 7,598
Earnings per share of common stock			
Basic earnings per share:	$ 0.37	$ 0.11	$ 0.63
Diluted earnings per share:	$ 0.34	$ 0.10	$ 0.58

The unaudited pro forma financial information shown above is derived from preliminary financial data, is presented for illustrative purposes only and is not necessarily indicative of the operating results that would have been achieved had the Acquisition been completed as of the dates indicated above or of the results that may be obtained in the future.

In connection with the SES Acquisition, the Company entered into a $240 million credit agreement with First Union National Bank, as the lead bank, consisting of a term loan in the aggregate principal amount of $140 million (Term Loan) and a $100 million revolving line of credit (Line of Credit) (collectively referred to as the Credit Facility). The maturity dates of the Term Loan and the Line of Credit are September 30, 2008, and September 30, 2006, respectively. The Term Loan requires quarterly principal payments beginning on December 31, 2001. Borrowings under the Credit Facility bear interest based on LIBOR (London Interbank Offered Rate), United States Prime Rate or United States Federal Funds Rate. The Credit Facility is secured by substantially all of the assets of the Company. There are certain covenants and restrictions placed on the Company under the Credit Facility, including a maximum total leverage ratio and a minimum fixed charge ratio, a restriction on the payment of dividends on the capital stock of the Company, a limitation on the issuance of additional debt and certain other restrictions. The interest rates on the Company's outstanding Term Loan and Line of Credit borrowings were approximately 5.9% and 5.7%, respectively, at September 30, 2001.

The proceeds of the Credit Facility at the date of the SES Acquisition of $161 million were used to acquire SES and repay the balance of the debt outstanding under DRS's previous credit facility with Mellon Bank, N.A. (the Mellon Facility) in the amount of $88.5 million. At September 30, 2001, the $161 million outstanding under the Credit Facility consisted of a $140 million term loan and a $21 million borrowing under the revolving line of credit. As of September 30, 2001, the Company had approximately $51.0 million available under the revolving line of credit, after satisfaction of its borrowing base requirement and certain restrictions.

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DRS TECHNOLOGIES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

On August 22, 2001, we acquired certain assets and liabilities of the Electro-Mechanical Systems (EMS) business of Lockheed Martin for approximately $4.0 million in cash, subject to adjustment. EMS, located in Largo, Florida, produces systems and antenna for radar and other surveillance sensor systems. The acquisition of EMS provides certain product synergies and vertical business integration opportunities for DRS. EMS is now operating as DRS Surveillance Support Systems, Inc. (SSS), a unit of the Company's Electronic Systems Group. The Company is in the process of obtaining a third-party valuation of the assets acquired and the liabilities assumed, thus the allocation of the purchase price is subject to adjustment. The financial position and results of operations of SSS were not significant to those of the Company as of the acquisition date or for the period ended September 30, 2001.

3. INVENTORIES

Inventories are summarized as follows:

	(IN THOUSANDS) SEPTEMBER 30, 2001	MARCH 31, 2001
Work-in-process	$ 127,688	$ 83,058
Raw material and finished goods	14,159	7,992
	141,847	91,050
Less progress payments	(30,941)	(16,723)
Total	$ 110,906	$ 74,327

General and administrative costs included in work-in-process were approximately $17.5 million and $14.5 million at September 30, 2001 and March 31, 2001, respectively. General and administrative expenses included in costs and expenses amounted to approximately $21.5 million and $19.9 million for the three-month periods ended September 30, 2001 and 2000, respectively, and approximately $42.2 million and $36.7 million for the six-month periods then ended. Included in those amounts are expenditures for internal research and development amounting to approximately $2.5 million and $2.0 million for the fiscal quarters ended September 30, 2001 and 2000, respectively and approximately $4.6 million and $4.1 million, respectively, for the six-month periods then ended.

4. GOODWILL AND INTANGIBLE ASSETS

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards Nos. 141 and 142 (SFAS 141 and SFAS 142), "Business Combinations" and "Goodwill and Other Intangible Assets", respectively. SFAS 141 replaces APB 16 and requires the use of the purchase method for all business combinations initiated after June 30, 2001. It also provides guidance on purchase accounting related to the recognition of intangible assets, noting that any purchase price allocated to an assembled workforce may not be accounted for separately, and accounting for negative goodwill. SFAS 142 changes the accounting for goodwill from an amortization method to an impairment-only approach. Under SFAS 142, goodwill will be tested annually and whenever events or circumstances occur indicating that goodwill might be impaired.

The Company elected to adopt the provisions of SFAS 141 and 142 as of April 1, 2001. The Company has identified its reporting units to be its operating segments and has determined the carrying value of each reporting unit by assigning assets and liabilities, including the existing goodwill and intangible assets, to those reporting units as of April 1, 2001. Upon adoption of SFAS 142, amortization of goodwill recorded for business combinations consummated prior to July 1, 2001 ceased, and intangible assets acquired prior to July 1, 2001 that did not meet the criteria for recognition apart from goodwill under SFAS 141 were reclassified to goodwill. In connection with the adoption of SFAS 142, the Company was required to perform a transitional goodwill impairment assessment within six months of adoption. The Company completed its transitional goodwill impairment assessment in the second quarter of fiscal 2002 with no adjustment to its April 1, 2001 goodwill. The annual impairment test will be performed in the fourth quarter of each fiscal year, after completion of the Company's annual operating plan.

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DRS TECHNOLOGIES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

The following disclosure presents certain information on the Company's acquired intangible assets as of September 30, 2001, and March 31, 2001: (All intangible assets are being amortized over their estimated useful lives, as indicated below, with no estimated residual values.)

		(IN THOUSANDS)		
ACQUIRED INTANGIBLE ASSETS	WEIGHTED AVERAGE AMORTIZATION PERIOD	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	NET BAL

As of September 30, 2001				
Amortized acquired intangible assets:				
Technology based intangibles	22 years	$ 19,425	$ (4,560)	$ 1
Customer related intangibles	21 years	7,630	(1,351)	
		$ 27,055	$ (5,911)	$ 2
As of March 31, 2001				
Amortized acquired intangible assets:				
Technology based intangibles	22 years	$ 18,225	$ (4,032)	$ 1
Customer related intangibles	21 years	7,630	(1,166)	
Workforce	16 years	7,628	(757)	
Technical infrastructure	20 years	5,280	(638)	
Other	30 years	1,700	(958)	
		$ 40,463	$ (7,551)	$ 3

The aggregate acquired intangible amortization expense for the three- and six-month periods ended September 30, 2001 was approximately $316,000 and $713,000, respectively. The estimated acquired intangible amortization expense for the fiscal year ending March 31, 2002 and for each of the subsequent four fiscal years ending March 31, 2006, excluding any amortization that may result from the SES or EMS acquisitions, is $1.4 million and $1.3 million, respectively.

The table below reconciles the change in the carrying amount of goodwill, by operating segment, for the period from March 31, 2001 to September 30, 2001, excluding the SES and EMS acquisitions. The Company recorded an $11.5 million reduction in goodwill in the second quarter of fiscal 2002 in connection with the reversal of an accrual for future costs on expired options associated with certain acquired contracts.

(IN THOUSANDS)

	ELECTRONIC SYSTEMS GROUP	ELECTRO-OPTICAL SYSTEMS GROUP	FLIGHT SAFETY AND COMMUNICATIONS GROU
Balance as of March 31, 2001	$ 31,450	$ 20,236	$ 24,661
Effect of adoption of SFAS 141 and 142:			
Workforce	--	3,807	3,064
Technical infrastructure	--	4,642	--
Other	--	--	742
Existing technology	--	--	(1,155
Adjustments	--	--	--
Balance as of April 1, 2001	$ 31,450	$ 28,685	$ 27,312
Adjustment on acquired contract	--	(11,492)	--
Foreign currency translation adjustment	262	--	(11
Balance as of September 30, 2001	$ 31,712	$ 17,193	$ 27,301

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

The following pro forma information reconciles the net earnings reported for the period ended September 30, 2001 and September 30, 2000 to adjusted net earnings reflecting the adoption of SFAS 142:

	(IN THOUSANDS, EXCEPT PER		
	THREE MONTHS ENDED SEPTEMBER 30,		
	2001	2000	2
Reported net earnings	$ 4,483	$ 2,239	$
Add back:			
Goodwill and related intangible amortization, net of tax benefit of $668 and $1,276	--	754	
Adjusted net earnings	$ 4,483	$ 2,993	$
Basic earnings per share:			
Reported net earnings	$ 0.37	$ 0.22	$
Add back:			
Goodwill and related intangible amortization, net of tax benefit of $.07 and $.13 per share, respectively	--	0.08	
Adjusted net earnings	$ 0.37	$ 0.30	$
Diluted earnings per share:			
Reported net earnings	$ 0.34	$ 0.20	$
Add back:			
Goodwill and related intangible amortization, net of tax benefit of $.05 and $.10 per share, respectively	--	0.06	
Adjusted net earnings	$ 0.34	$ 0.26	$

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DRS TECHNOLOGIES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

5. EARNINGS PER SHARE

The following table presents a reconciliation of the numerators and denominators of basic and diluted earnings per share (EPS):

	(IN THOUSANDS, EXCEPT PER SHARE DATA) THREE MONTHS ENDED SEPTEMBER 30, 2001	2000	SIX MONTHS ENDED SEPTEMBER 30, 2001	2000
Basic EPS computation:				
Net earnings	$ 4,483	$ 2,239	$ 8,381	$ 4,13
Weighted average common shares outstanding	12,142	10,001	12,118	9,67
Basic earnings per share	$ 0.37	$ 0.22	$ 0.69	$ 0.4
Diluted EPS computation:				
Net earnings	4,483	2,239	$ 8,381	$ 4,13
Interest and expenses related to convertible debentures	--	196	--	43
Adjusted net earnings	4,483	2,435	8,381	4,57
Diluted common shares outstanding:				
Weighted average common shares outstanding	12,142	10,001	12,118	9,67
Stock options and warrants	1,039	535	989	49
Convertible debentures	--	1,808	--	1,98
Diluted common shares outstanding	13,181	12,344	13,107	12,15
Diluted earnings per share	$ 0.34	$ 0.20	$ 0.64	$ 0.3

6. COMPREHENSIVE EARNINGS

The components of comprehensive earnings for the three- and six-month periods ended September 30, 2001 and 2000 consisted of the following:

	(IN THOUSANDS) THREE MONTHS ENDED SEPTEMBER 30, 2001	2000	SIX MONTHS SEPTEMBER 2001
Net earnings	$ 4,483	$ 2,239	$ 8,381
Other comprehensive earnings (losses):			
Foreign currency translation adjustments	587	(469)	802
Unrealized losses on hedging instruments:			
Cumulative adjustment at April 1, 2001	--	--	(289)
Unrealized losses arising during the period	(434)	--	(505)
Comprehensive earnings	$ 4,636	$ 1,770	$ 8,389

At September 30, 2001, accumulated other comprehensive losses totaled approximately $4.0 million and consisted of $3.2 million and $794,000 for foreign currency translation adjustments and unrealized losses on hedging instruments, respectively. At March 31, 2001, the $4.0 million balance consisted of foreign currency translation adjustments.

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

7. DERIVATIVE FINANCIAL INSTRUMENTS

Effective April 1, 2001, the Company adopted SFAS 133. This Statement requires the recognition of all derivative instruments as either assets or liabilities in the consolidated balance sheet, and the periodic adjustment of those instruments to fair value. The classification of gains and losses resulting from changes in the fair values of derivatives is dependent on the intended use of the derivative and its resultant designation.

The Company utilizes variable rate debt to maintain its operations and sustain its growth. Such variable rate borrowings expose the Company to interest rate risk and the related impact that changes in interest rates can have on the Company's earnings and on its cash flows. In an effort to limit its interest expense and cash flow exposure the Company entered into interest rate collar agreements with notional amounts covering a limited amount of the aggregate outstanding principal balance of the Company's term loans. The following is a summary of the Company's interest rate collar agreements in place as of September 30, 2001 and March 31, 2001:

EFFECTIVE DATE	EXPIRATION DATE	(IN THOUSANDS) NOTIONAL AMOUNT SEPTEMBER 30, 2001	MARCH 31, 2001	VARIABLE RATE BASE	CEIL RAT
April 22, 1999	January 26, 2002	$20,000	$20,000	3 Month LIBOR	5.7
January 26, 2001	January 30, 2003	$10,000	$10,000	3 Month LIBOR	6.5
January 29, 2001	January 31, 2003	$10,000	$10,000	3 Month LIBOR	6.5

On April 1, 2001, in accordance with the provisions in SFAS 133, the Company designated its interest rate collars as cash flow hedges and recorded the fair value of the instruments on the balance sheet at that date, with a corresponding adjustment to comprehensive earnings. Due to the nature and characteristics of the Company's designated hedging instruments, all adjustments to the fair values of such instruments will be adjusted via comprehensive earnings. The effect of adopting SFAS 133 at April 1, 2001, and the amounts recorded related to its derivative financial instruments as of and for the three- and six-month periods ended September 30, 2001, were not material to the Company's consolidated financial position and did not impact the Company's consolidated results of operations or cash flows.

8. OPERATING SEGMENTS

DRS operates in three principal business segments on the basis of products and services offered: the Electronic Systems Group (ESG), the Electro-Optical Systems Group (EOSG), and the Flight Safety and Communications Group (FSCG). All other operations are grouped in "Other." During the first quarter of fiscal 2002, the Company's operating subsidiary, DRS Photronics, Inc. (DRS Photronics) was combined with DRS' Flight Safety and Communications Group for management purposes, based primarily on operational synergies. DRS Photronics had previously been managed as part of the Electro-Optical Systems Group. Prior-year balances and results of operations disclosed herein have been restated to give effect to this change.

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Information about the Company's segments for the fiscal quarters ended September 30, 2001 and 2000 are as follows:

	(IN THOUSANDS)			
	ESG	EOSG	FSCG	OTHER
QUARTER ENDED SEPTEMBER 30, 2001				
Total revenues	$ 53,120	$ 40,737	$ 22,013	$ 2,248
Intersegment revenues	--	(370)	(1,570)	--
External revenues	$ 53,120	$ 40,367	$ 20,443	$ 2,248
Operating income (loss)	$ 4,226	$ 5,340	$ 1,483	$ (346)
Identifiable assets	$ 116,554	$ 179,446	$ 99,531	$ 23,810
Depreciation and amortization	$ 435	$ 1,268	$ 908	$ 470
Capital expenditures	$ 424	$ 2,285	$ 389	$ 856
QUARTER ENDED SEPTEMBER 30, 2000				
Total revenues	$ 45,688	$ 36,879	$ 22,026	$ 2,636
Intersegment revenues	--	(2)	--	--
External revenues	$ 45,688	$ 36,877	$ 22,026	$ 2,636
Operating income (loss)	$ 3,762	$ 5,229	$ (796)	$ 308
Identifiable assets	$ 104,148	$ 128,709	$ 87,444	$ 16,616
Depreciation and amortization	$ 909	$ 1,755	$ 1,184	$ 554
Capital expenditures	$ 1,019	$ 3,165	$ 834	$ 814
SIX MONTHS ENDED SEPTEMBER 30, 2001				
Total revenues	$ 91,216	$ 82,670	$ 44,310	$ 4,484
Intersegment revenues	(17)	(464)	(2,669)	--
External revenues	$ 91,199	$ 82,206	$ 41,641	$ 4,484
Operating income (loss)	$ 9,034	$ 9,817	$ 2,284	$ (748)
Identifiable assets	$ 116,554	$ 179,446	$ 99,531	$ 23,810
Depreciation and amortization	$ 809	$ 2,539	$ 1,672	$ 942
Capital expenditures	$ 1,255	$ 4,049	$ 1,013	$ 1,163
SIX MONTHS ENDED SEPTEMBER 30, 2000				
Total revenues	$ 87,225	$ 72,538	$ 37,178	$ 4,818
Intersegment revenues	--	(11)	--	--

External revenues	$ 87,225	$ 72,527	$ 37,178	$ 4,818
Operating income (loss)	$ 6,262	$ 9,100	$ 108	$ 188
Identifiable assets	$ 104,148	$ 128,709	$ 87,444	$ 16,616
Depreciation and amortization	$ 1,790	$ 3,491	$ 2,161	$ 1,102
Capital expenditures	$ 1,514	$ 3,921	$ 1,964	$ 1,013

9. SUPPLEMENTAL CASH FLOW INFORMATION

	(IN THOUSANDS) SIX MONTHS ENDED SEPTEMBER 30,	
	2001	2000
Cash paid for:		
Income taxes	$ 9,573	$ 4,917
Interest	$ 4,390	$ 6,686
Noncash Investing and Financing Activities:		
Deferred acquisition costs for business combinations	$ 3,461	$ --
Common stock issued for business combinations	$ --	$ 4,000
Note receivable - sale of magnetic tape head business	$ --	$ 1,741
Conversion of 9% convertible debentures	$ --	$ 8,752

10. CONTINGENCIES

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

In April and May 1998, subpoenas were issued to the Company by the United States Attorney for the Eastern District of New York seeking documents related to a governmental investigation of certain equipment manufactured by DRS Photronics, Inc. (DRS Photronics). These subpoenas were issued in connection with United States v. Tress, a case involving a product substitution allegation against an employee of DRS Photronics. On June 26, 1998, the complaint against the employee was dismissed without prejudice. Although additional subpoenas were issued to the Company on August 12, 1999 and May 10, 2000, to date, no claim has been made against the Company or DRS Photronics. During the Government's investigation, until October 29, 1999, DRS Photronics was unable to ship certain equipment related to the case, resulting in delays in the Company's recognition of revenues. On October 29, 1999, DRS Photronics received authorization to ship its first boresight system since the start of the investigation.

The Company is presently involved in a dispute in arbitration with Spar

Aerospace Limited (Spar) with respect to the working capital adjustment, if any, provided for in the purchase agreement between the Company and Spar dated as of September 19, 1997, pursuant to which the Company acquired, through certain of its subsidiaries, certain assets of Spar. The Company is also in a dispute with Raytheon Company (Raytheon) with respect to the working capital adjustment (not to exceed $7.0 million), if any, provided for in the purchase agreement between the Company and Raytheon dated as of July 28, 1998, pursuant to which the Company acquired, through certain subsidiaries, certain assets of Raytheon.

On October 3, 2001, a lawsuit was filed in the United States District Court of the Eastern District of New York by Miltope Corporation, a corporation of the State of Alabama, and IV Phoenix Group, Inc., a corporation of the State of New York, against DRS Technologies, Inc., DRS Electronic Systems, Inc., and a number of individual defendants, several of whom are employed by DRS Electronic Systems. The complaint alleges, among other things, that DRS and /or the other defendants infringed upon certain patents, misappropriated trade secrets and breached a confidentiality agreement. Plaintiffs request monetary and equitable relief. In its answer, DRS has denied the plaintiffs' allegations, which it believes are without merit, and DRS intends to vigorously defend this action.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is management's discussion and analysis (MD&A) of the consolidated financial condition and results of operations of DRS Technologies, Inc. and Subsidiaries (hereinafter, we, us, our, the Company or DRS) as of September 30, 2001 and for the three- and six-month periods ended September 30, 2001 and 2000. This discussion should be read in conjunction with the audited Consolidated Financial Statements and related notes.

The following discussion and analysis contains certain forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements in this report are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Persons reading this report are cautioned that risks and uncertainties are inherent to forward-looking statements. Accordingly, our actual results could differ materially from those suggested by such forward-looking statements.

BUSINESS COMBINATIONS

On September 28, 2001, we acquired certain assets and liabilities of the Sensors and Electronic Systems (SES) business of The Boeing Company (Boeing)(the Acquisition). We paid approximately $67.1 million in cash, subject to adjustment, for the Acquisition. In addition to the purchase price, we have estimated that costs related to the Acquisition, including professional fees, will be approximately $4.0 million. SES, located in Anaheim, California, is a leading provider of advanced electro-optical airborne and naval surveillance and targeting systems, high-performance military infrared cooled sensor systems, and infrared uncooled sensor products for military and commercial applications. This acquisition broadens our product lines and customer base of our Electro-Optical Systems Group, particularly in those areas associated with naval and air-based applications, and provides a strong complement to our existing products in ground-based Forward Looking Infrared technology. SES is now operating as DRS Sensors & Targeting Systems, Inc., a unit of our Electro-Optical Systems Group. The SES assets acquired and liabilities assumed have been included in our consolidated financial statements as of the date of acquisition.

We are in the process of obtaining a third-party valuation of the assets acquired and the liabilities assumed as well as performing our own internal assessment, thus, the allocation of the purchase price is subject to adjustment. In addition, in connection with the Acquisition, we may incur costs associated with exiting certain activities, including severance costs. It is our expectation that a certain amount of the purchase price will be allocated to acquired identifiable intangible assets, with such assets requiring amortization. As we are unable to estimate the amount of acquired identifiable intangible assets at this time, the entire excess of purchase price over the tangible net assets acquired has been included as a separate line item on the balance sheet as of September 30, 2001. In addition, since the Acquisition was completed at the end of the quarter and we are unable to estimate the ultimate amount of acquired intangibles at this time, there is no amortization expense related to this acquisition in the results of operations. This allocation will be adjusted during the second half of fiscal 2002.

On August 22, 2001, we acquired certain assets and liabilities of the Electro-Mechanical Systems (EMS) business of Lockheed Martin for approximately $4.0 million in cash, subject to adjustment. EMS, located in Largo, Florida, produces systems and antenna for radar and other surveillance sensor systems. The acquisition of EMS provides certain product synergies and vertical business integration opportunities for us. EMS is now operating as DRS Surveillance Support Systems, Inc., a unit of our Electronic Systems Group. The financial position and results of operations of SSS were not significant to those of DRS as of the acquisition date or for the period ended September 30, 2001.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards Nos. 141 and 142 (SFAS 141 and SFAS 142), "Business Combinations" and "Goodwill and Other Intangible Assets," respectively. SFAS 141 replaces APB 16 and requires the use of the purchase method for all business combinations initiated after June 30, 2001. It also provides guidance on purchase accounting related to the recognition of intangible assets, noting that any purchase price allocated to an assembled workforce may not be accounted for separately, and accounting for negative goodwill. SFAS 142 changes the accounting for goodwill from an amortization method to an impairment-only approach. Under SFAS 142, goodwill will be tested annually and whenever events or circumstances occur indicating that goodwill might be impaired.

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DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

We elected to adopt the provisions of SFAS 141 and 142 as of April 1, 2001. We have identified our reporting units to be our operating segments and we have determined the carrying value of each reporting unit by assigning assets and liabilities, including the existing goodwill and intangible assets, to those reporting units as of April 1, 2001. Upon adoption of SFAS 142, amortization of goodwill recorded for business combinations consummated prior to July 1, 2001 ceased, and intangible assets acquired prior to July 1, 2001 that did not meet the criteria for recognition apart from goodwill under SFAS 141 were reclassified to goodwill. The Company completed its transitional goodwill impairment assessment in the second quarter of fiscal 2002 with no adjustment to its April 1, 2001 goodwill necessary. The annual impairment test will be performed in the fourth quarter of each fiscal year, after completion of the Company's annual operating plan.

In October 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144, ("SFAS 144"), "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS 144 supersedes SFAS 121 but retains its fundamental provisions for the (a) recognition / measurement of impairment of long-lived assets to be held and used and (b) measurement of long-lived assets to be disposed of by sale. SFAS 144 also supersedes the accounting / reporting provisions of APB Opinion No. 30 for segments of a business to be disposed of but retains the requirement to report discontinued operations separately from continuing operations and extends that reporting to a component of an entity that either has been disposed of or is classified as held for sale. SFAS 144 is effective for us on April 1, 2002. We are currently evaluating the impact of this new standard.

RESULTS OF OPERATIONS

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

CONSOLIDATED SUMMARY

Consolidated revenues for the three- and six-month periods ended September 30, 2001 increased approximately $9.0 million and $17.8 million, respectively, as compared with the corresponding prior-year periods. The increase in revenues in the second quarter of fiscal 2002 was driven by increased shipments of combat display workstations and the continued growth of our second generation infrared sighting and targeting systems programs. The revenue increase in the year-to-date period ended September 30, 2001 was also favorably impacted by the growth of our second generation infrared sighting and targeting systems programs, as well as the impact of the inclusion of six months of revenues generated by DRS Communications Company, which we acquired at the end of the first quarter of fiscal 2001. Partially offsetting the revenue increases in both the quarter and year-to-date periods ended September 30, 2001 were decreases in mission data recording systems. Operating income increased approximately 26% and 30% to $10.7 million and $20.4 million, respectively from the same three- and six-month periods in fiscal 2001. The increases in operating income were due primarily to the overall increases in revenues and the positive impact of our fiscal 2002 first quarter adoption of SFAS 141 and SFAS 142 (see Note 4 of Notes to Condensed Consolidated Financial Statements). In accordance with the provisions of these standards, we ceased amortizing goodwill effective April 1, 2001. The adoption of SFAS 141 and 142 contributed approximately $1.2 million and $2.5 million to the Company's fiscal 2002 second quarter and year-to-date operating income, respectively. Had these standards been effective in the prior year, our operating income, for the three- and six-month periods ended September 30, 2000, would have been $1.4 million higher and $2.7 million higher, respectively. Partially offsetting the increases in operating income were the impact of certain charges at our operating segments. See discussion of operating segments below for additional information. Also impacting the overall increases in revenues and operating income was the inclusion of the operating results of our fiscal 2002 second quarter acquisition of DRS Surveillance Support Systems, Inc.

Interest and related expenses decreased approximately $1.7 and $2.7 million for the three- and six-month periods ended September 30, 2001 as compared with the corresponding prior-year periods. These decreases were primarily the result of 46% and 47% decreases in average working capital borrowings outstanding during the three- and six-month periods ended September 30, 2001, respectively, as compared with the corresponding prior-year periods, the favorable impact of the conversion of all of our 9% Senior Subordinated Convertible Debentures during the second half of fiscal 2001, and an overall decrease in weighted average interest rates in fiscal 2002, as compared with fiscal 2001.

The provision for income taxes for the quarter- and year-to-date periods ended September 30, 2001 reflects an annual estimated effective income tax rate of approximately 47%, as compared with 52% and 51%, respectively, in the comparable prior year periods of fiscal 2001. The decrease in our effective tax rate is primarily due to the adoption of SFAS 142. It is anticipated that the Company's effective tax rate may also decline moderately in future years as the Company continues to grow.

Earnings before interest, income taxes, depreciation and amortization (EBITDA) for the three- and six-month periods ended September 30, 2001 were $13.4 million and $25.7 million, respectively, increases of approximately 7% and 9% over the corresponding prior year periods, respectively.

OPERATING SEGMENTS

We operate in three principal business segments on the basis of products and services offered: the Electronic Systems Group (ESG), the Electro-Optical Systems Group (EOSG), and the Flight Safety and Communications Group (FSCG). All other operations are grouped in "Other."

During the first quarter of fiscal 2002, one of our operating subsidiaries, DRS Photronics, Inc., (DRS Photronics) was combined with DRS' Flight Safety and Communications Group for management purposes based primarily on operational synergies. DRS Photronics had previously been managed as part of the Electro-Optical Systems Group. Prior-year balances and results of operations disclosed in this MD&A have been restated to give effect to this change.

ELECTRONIC SYSTEMS GROUP

Our Electronic Systems Group is a leader in the development, production and support of high-performance combat display workstations used by the U.S. Navy. In addition, we supply the military and intelligence communities with signal processing systems and computer systems adapted, or "ruggedized," for harsh environments. By incorporating advanced commercial computing technology, we provide rapidly fielded and cost-effective system solutions to enhance the military's ability to attain information dominance in land, sea and air applications. Our systems are used by the U.S. Navy and other military and intelligence communities and are deployed on a number of front-line platforms, including DDG-51 Aegis destroyers and cruisers, aircraft carriers, submarines and surveillance aircraft. Our family of rugged computer products is also used in the U.S. Army's ongoing battlefield digitization program.

ELECTRO-OPTICAL SYSTEMS GROUP

We are a leading provider of sophisticated thermal imaging and targeting systems. Our Electro-Optical Systems Group is one of only two key suppliers to the U.S. government for advanced focal plane array technology. We design, manufacture and market thermal imaging systems that allow the operator to detect, identify and target objects based upon their infrared signatures under adverse conditions such as darkness, fog, smoke and dust. These systems are used in the U.S. Army's battlefield platforms which include the M1A2 Abrams Main Battle Tank, the M2A3 Bradley Fighting Vehicle, the HMMWV scout vehicle and the Javelin missile program. Moreover, we also design and manufacture eye-safe laser range finders. In addition to military applications, we are leveraging our technology base by expanding our products into related non-defense markets. For example, we manufacture electro-optical modules for commercial devices used in corrective laser eye surgery.

FLIGHT SAFETY AND COMMUNICATIONS GROUP

Our Flight Safety and Communications Group supplies airborne deployable recorders and surveillance and communications systems. We are the leading manufacturer of deployable flight emergency, or "black box," voice and data recording equipment for the U.S. and international militaries, as well as for commercial customers. The recorder ejects automatically from an aircraft prior to impact, minimizing the damage to the recorder and facilitating its recovery. We have provided over 4,000 deployable recorders for military and search and rescue aircraft. We also manufacture integrated naval ship communications systems, information management systems, coastal border surveillance radar systems, ultra high-speed digital imaging systems and multiple-platform weapons calibration systems for diverse air platforms such as the AH-64 Apache attack helicopter and the AC-130U gunship. In addition, we provide electronics manufacturing services, often with value-added engineering content, to the defense and space industries.

OTHER

"Other" includes the activities of DRS Corporate Headquarters and DRS Ahead Technology. DRS Ahead Technology is a commercial operation that produces magnetic head components used in the manufacturing process of computer disk drives, which burnish and verify the quality of disk surfaces. DRS Ahead Technology also services and manufactures magnetic video recording heads used in broadcast television equipment.

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

(IN THOUSANDS, EXCEPT FOR PERCENTAGES)

	THREE MONTHS ENDED SEPTEMBER 30,		THREE MONTHS ENDED PERCENT CHANGES	SIX MONTHS ENDED SEPTEMBER 30,	
	2001	2000	2001 VS. 2000	2001	2000
ESG					
External revenues	$ 53,120	$ 45,688	16.3%	$ 91,199	$87,225
Operating income	$ 4,226	$ 3,762	12.3%	$ 9,034	$ 6,262
Operating margin	8.0%	8.2%	(2.4%)	9.9%	7.2%
EOSG					
External revenues	$ 40,367	$ 36,877	9.5%	$ 82,206	$72,527
Operating income	$ 5,340	$ 5,229	2.1%	$ 9,817	$ 9,100
Operating margin	13.2%	14.2%	(7.0%)	11.9%	12.5%
FSCG					

External revenues	$ 20,443	$ 22,026	(7.2%)	$ 41,641	$37,178
Operating income	$ 1,483	$ (796)	286.3%	$ 2,284	$ 108
Operating margin	7.3%	(3.6%)	302.8%	5.5%	0.3%
Other					
External revenues	$ 2,248	$ 2,636	(14.7%)	$ 4,484	$ 4,818
Operating loss	$ (346)	$ 308	(212.3%)	$ (748)	$ 188
Operating margin	(15.4%)	11.7%	(231.6%)	(16.7%)	3.9%

ELECTRONIC SYSTEMS GROUP: Our Electronic Systems Group's revenues increased $7.4 and $4.0 million, or approximately 16% and 5%, for the three- and six-month periods ended September 30, 2001, respectively, as compared with the corresponding prior year periods. The increases in revenues were due primarily to increased shipments of combat display workstations as well as approximately $1.5 million of revenue contributed by DRS Surveillance Support Systems, Inc., which we acquired during the second quarter of this fiscal year. These increases were partially offset by decreases in revenues from certain rugged computer systems and peripherals. Operating income increased $464,000 and $2.8 million for the quarter and year-to-date periods ended September 30, 2001, as compared with the respective fiscal 2001 periods. The increase in second quarter operating income was due to the favorable impact of the elimination of approximately $448,000 in goodwill amortization, offset in part by unfavorable operating margins in the group's U.K. operations. The increase in operating income during the first half of fiscal 2002, as compared with the corresponding prior year period, was primarily driven by the increase in revenues, operating margin improvements due to a change in product mix, as well as the elimination of goodwill amortization, which contributed approximately $896,000 in operating income in the six-month period ended September 30, 2001. Had SFAS 142 been effective in the prior year, operating income would have been $482,000 higher and $969,000 higher for the three- and six-month periods ended September 30, 2000, respectively.

ELECTRO-OPTICAL SYSTEMS GROUP: Our Electro-Optical Systems Group's revenues and operating income increased $3.5 million and $109,000, or approximately 9% and 2%, respectively, for the three-month period ended September 30, 2001, as compared to the corresponding prior year period. The increase in revenues was driven by growth in our second generation infrared targeting and imaging systems programs and shipments of certain commercial electro-optical products. The slight increase in operating income resulted from the elimination of goodwill amortization, which contributed approximately $434,000 to the EOSG operating segment in the three-month period ended September 30, 2001. Had SFAS 142 been effective in the prior year, operating income would have been $566,000 higher for the three-month period ended September 30, 2000. Excluding the benefit of eliminating goodwill amortization, operating income would have been down slightly over the corresponding period in the prior year. Driving the slight decrease in fiscal 2002 operating income and operating margins was the fact that EOSG's operating income for the three-month period ended September 30, 2000 included a favorable program adjustment of $1.1 million to reflect the realization of management's reductions in overall production costs on certain long-term production programs.

Revenues and operating income increased $9.7 million and $717,000, or approximately 13% and 8%, respectively, for the six-month period ended September 30, 2001, as compared to the corresponding prior year period. The increase in revenues is attributed to the continued growth on our second generation electro-optical targeting and imaging systems offset, in part, by decreased shipments of certain commercial electro-optical products during the first quarter. The elimination of goodwill amortization contributed approximately $888,000 to the EOSG operating segment in the six-month period ended September 30, 2001. Had this standard been effective in the prior year, operating income would have been $1.1 million higher for the six-month period ended September 30, 2000. Excluding the benefit of eliminating goodwill amortization, operating income in the first half of the current fiscal year would have been relatively flat due to the $1.1 million program adjustment discussed above as well as the impact of a fiscal 2002 first quarter charge of $650,000 for a certain commercial product line.

FLIGHT SAFETY AND COMMUNICATIONS GROUP: Our Flight Safety and Communications Group's revenues decreased $1.6 million, or approximately 7%, for the three-month period ended September 30, 2001, as compared with the corresponding prior year period. Increased volume in the group's contract manufacturing business, as well as increased shipments of deployable flight incident recorders (DFIRS) and ultra high-speed cameras were more than off-set by decreased shipments of communications data links and airborne separation video systems. Operating income increased $2.3 million for the three-month period ended September 30, 2001, as compared to the corresponding prior year period. The increase in operating income is a result of overall higher operating margins, as compared to the corresponding prior year period, primarily for DFIRS, ultra-high speed cameras, certain avionic equipment and contract

manufacturing. The elimination of goodwill amortization contributed approximately $348,000 in operating income to the FSCG operating segment in the three-month period ended September 30, 2001. Had SFAS 142 been effective in the prior year, operating income would have been $364,000 higher for the three-month period ended September 30, 2000. The three-month period ended September 30, 2000 also included a charge of approximately $1.4 million for additional costs associated with the development of a certain mission data recording system.

Revenue increased approximately $4.5 million for the six-month period ended September 30, 2001, as compared to the corresponding prior year period. The increase in revenues was primarily driven by our acquisition of DRS Communications Company in the latter part of the first quarter of fiscal 2001. Excluding the results of DRS Communications Company, FSCG's revenues decreased $1.7 million, or 6%. This decrease is attributable to a decrease in shipments of certain products as discussed above. Operating income increased approximately $2.2 million for the six-month period ended September 30, 2001, as compared to the corresponding prior year period. The primary drivers behind the increase in operating income are the same as those indicated above for the second quarter of fiscal 2002, off-set in part by a fiscal 2002 first quarter charge of $765,000 associated with shutting down FSCG's Santa Clara, California production and engineering facility. The elimination of goodwill amortization contributed approximately $700,000 in operating income to the FSCG operating segment in the six-month period ended September 30, 2001. Had this standard been effective in the prior year, operating income would have been $628,000 higher for the six-month period ended September 30, 2000.

OTHER: Revenues for the three- and six-month periods ended September 30, 2001 decreased 15% and 7%, respectively, as compared to the corresponding prior year periods. Operating loss increased by approximately $654,000 and $936,000 in the three- and six-months ended September 30, 2001, respectively, as compared with the prior year periods. The decrease in revenue and increase in the operating loss was primarily due to the continued soft demand in the disk drive marketplace.

FINANCIAL CONDITION AND LIQUIDITY

CASH AND CASH FLOW

The following table provides cash flow data for the Company for the six-month periods ended September 30, 2001and 2000:

	(IN THOUSANDS) SIX MONTHS ENDED SEPTEMBER 30,	
	2001	2000
Net cash provided by operating activities	$ 3,853	$ 13,442
Net cash used in investing activities	$ (79,340)	$ (12,030)
Net cash provided by financing activities	$ 76,350	$ 3,123

Operating cash flow for the six-month period ended September 30, 2001 decreased by approximately $9.6 million as compared with the corresponding prior-year period. Increases in earnings (net of adjustments for non-cash items), receivable collections and customer advances were more than offset by increases in inventories and other current assets and a decrease in certain current liabilities.

Cash used in investing activities for the six-month period ended September 30, 2001 consisted of payments made to acquire SES and EMS of $67.1 million and $4.0 million, respectively. The remaining uses were comprised of capital expenditures.

In connection with the SES Acquisition, we entered into a $240 million credit agreement with First Union National Bank, as the lead bank, consisting of a term loan in the aggregate principal amount of $140 million (Term Loan) and a $100 million revolving line of credit (Line of Credit) (collectively referred to as the Credit Facility). The maturity dates of the Term Loan and the Line of Credit are September 30, 2008, and September 30, 2006, respectively. The Term Loan requires quarterly principal payments beginning on December 31, 2001. Borrowings under the Credit Facility bear interest based on LIBOR (London Interbank Offered Rate), United States Prime Rate or United States Federal Funds Rate. The Credit Facility is secured by substantially all of the assets of the Company. There are certain covenants and restrictions placed on us under the Credit Facility, including a maximum total leverage ratio and a minimum fixed charge ratio, a restriction on the payment of dividends on the capital stock of the Company, a limitation on the issuance of additional debt and certain other restrictions. The interest rates on our outstanding Term Loan and Line of Credit borrowings were approximately 5.9% and 5.7%, respectively, at September 30, 2001.

The proceeds of the Credit Facility at the date of the SES Acquisition of $161 million were used to acquire SES and repay the balance of the debt outstanding under DRS's previous credit facility with Mellon Bank, N.A. (the Mellon Facility) in the amount of $88.5 million. At September 30, 2001, the $161 million outstanding under the Credit Facility consisted of a $140 million term loan and a $21 million borrowing under the revolving line of credit. As of September 30, 2001, we had approximately $51.0 million available under the revolving line of credit, after satisfaction of our borrowing base requirement and certain restrictions.

Under the Mellon Facility, we paid approximately $1.8 million in principal payments against our two term loans, borrowed approximately $48.6 million under the revolving line of credit and repaid approximately $40.4 million. The borrowings under our revolving line of credit were used to meet temporary working capital requirements and to pay for the acquisition of EMS.

We actively seek to finance our business in a manner that preserves financial flexibility, while minimizing borrowing costs to the extent practicable. We continually review the changing financial, market and economic conditions to manage the types, amounts and maturities of our indebtedness. Cash and cash equivalents, internally generated cash flow from operations and other available financing resources are expected to be sufficient to meet anticipated operating, capital expenditure and debt service requirements during the next twelve months and the foreseeable future.

BACKLOG

Backlog at September 30, 2001 was approximately $569.2 million, including $75.5 million and $13.1 million from the acquisitions of SES and EMS, respectively. The backlog at March 31, 2001 was $456.5 million. We booked approximately $244.9 million in new orders in the first six months of fiscal 2002.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk", of our Annual Report on Form 10-K for the fiscal year ended March 31, 2001 for a discussion of our exposure to market risks. There was no significant change in those risks during the six months ended September 30, 2001.

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

In April and May 1998, subpoenas were issued to us by the United States Attorney for the Eastern District of New York seeking documents related to a governmental investigation of certain equipment manufactured by DRS Photronics, Inc. (DRS Photronics). These subpoenas were issued in connection with United States v. Tress, a case involving a product substitution allegation against an employee of DRS Photronics. On June 26, 1998, the complaint against the employee was dismissed without prejudice. Although additional subpoenas were issued to us on August 12, 1999 and May 10, 2000, to date, no claim has been made against us or DRS Photronics. During the Government's investigation, until October 29, 1999, DRS Photronics was unable to ship certain equipment related to the case, resulting in delays in our recognition of revenues. On October 29, 1999, DRS Photronics received authorization to ship such its first boresight system since the start of the investigation.

We are currently involved in a dispute in arbitration with Spar Aerospace Limited (Spar) with respect to the working capital adjustment, if any, provided for in the purchase agreement between us and Spar dated as of September 19, 1997, pursuant to which we acquired, through certain of our subsidiaries, certain assets of Spar. We are also in a dispute with Raytheon Company (Raytheon) with respect to the working capital adjustment, if any, provided for in the purchase agreement between us and Raytheon dated as of July 28, 1998, pursuant to which we acquired, through certain subsidiaries, certain assets of Raytheon.

On October 3, 2001, a lawsuit was filed in the United States District Court of the Eastern District of New York by Miltope Corporation, a corporation of the State of Alabama, and IV Phoenix Group, Inc., a corporation of the State of New York, against DRS Technologies, Inc., DRS Electronic Systems, Inc., and a number of individual defendants, several of whom are employed by DRS Electronic Systems. The complaint alleges, among other things, that we and /or the other defendants infringed upon certain patents, misappropriated trade secrets and breached a confidentiality agreement. Plaintiffs request monetary and equitable relief. In our answer, we have denied the plaintiffs' allegations, which we believe are without merit, and we intend to vigorously defend this action.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On August 8, 2001, the Company held its Annual Meeting of Stockholders at the Hilton Parsippany, One Hilton Court, Parsippany, New Jersey 07054. The following matters were submitted to a vote of stockholders:

(i) to elect four Class III directors, each to hold office for a term of three years;
(ii) to consider and vote upon a proposal to ratify and approve the designation of KPMG LLP as the independent certified public accountants for the Company; and
(iii) to consider and vote upon an amendment to the Company's Certificate of Incorporation to increase the number of authorized shares.

With respect to the aforementioned matters, votes were tabulated and the stockholders of the Company approved both proposals as follows:

	For	Withheld
Proposal (i):		
Stuart F. Platt	8,931,240	286,067
William F. Heitmann	9,160,898	56,409
Eric J. Rosen	8,935,150	282,157
C. Shelton James	9,161,371	55,936

	For	Against	Withheld

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Proposal (ii):	9,192,514	14,321	10,472
Proposal (iii):	9,120,282	71,465	25,560

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

Exhibit No.	Description

None

(b) Reports on Form 8-K

The following report on form 8-K was filed during the quarter ending December 31, 2001:

1. Form 8-K filed on October 12, 2002, in connection with DRS Technologies, Inc.'s acquisition of the Sensors and Electronics Systems Business of The Boeing Company.

SIGNATURES

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

DRS TECHNOLOGIES, INC.
Registrant

Date: November 14, 2001

/s/ Richard A. Schneider

Richard A. Schneider
EXECUTIVE VICE PRESIDENT, CHIEF FINANCIAL OFFICER AND TREASURER