DRS TECHNOLOGIES INC
Form 10-Q
February 08, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended December 31, 2007

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

For the transition period from to
Commission file number 1-8533

DRS Technologies, Inc.

(Exact name of registrant as specified in its charter)

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities and Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated filer ý Accelerated Filer o Non-accelerated filer o

Indicated by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No ý

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at February 4, 2008
Common Stock $0.01 par value	41,361,189

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES
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for the Quarter Ended December 31, 2007

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(in thousands, except share and per-share data)

(Unaudited)

	December 31, 2007	March 31, 2007
Assets		
Current assets		
Cash and cash equivalents	$ 48,185	$ 95,833
Accounts receivable, net of allowance for doubtful accounts of $2,266 and $1,703 as of December 31, 2007 and March 31, 2007, respectively	532,172	535,242
Inventories, net	420,735	367,612
Prepaid expenses, deferred income taxes and other current assets	137,407	126,975
Total current assets	1,138,499	1,125,662
Property, plant and equipment, less accumulated depreciation of $211,474 and $178,241 at December 31, 2007 and March 31, 2007, respectively	243,570	231,206
Acquired intangible assets, net	175,117	196,984
Goodwill	2,626,139	2,616,642
Deferred income taxes and other noncurrent assets	40,182	44,216
Total assets	$ 4,223,507	$ 4,214,710
Liabilities and Stockholders' Equity		
Current liabilities		
Current installments of long-term debt	$ 5,518	$ 5,161
Accounts payable	287,050	297,427
Accrued expenses and other current liabilities	509,516	467,944
Total current liabilities	802,084	770,532
Long-term debt, excluding current installments	1,654,335	1,783,046
Other liabilities	147,631	158,682
Total liabilities	2,604,050	2,712,260
Commitments and contingencies		
Stockholders' equity		
Preferred stock, $10 par value per share. Authorized 2,000,000 shares; none issued at December 31, 2007 and March 31, 2007		
Common Stock, $.01 par value per share. Authorized 100,000,000 shares; 41,358,110 and 40,673,944 shares issued at December 31, 2007 and March 31, 2007, respectively	413	407
Additional paid-in capital	1,125,826	1,099,991
Retained earnings	483,403	399,793

	December 31, 2007	March 31, 2007
Accumulated other comprehensive earnings	9,815	2,259
Total stockholders' equity	1,619,457	1,502,450
Total liabilities and stockholders' equity	$ 4,223,507	$ 4,214,710

See accompanying Notes to Consolidated Financial Statements.

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Consolidated Statements of Earnings

(in thousands, except per-share data)

(Unaudited)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2007	**2006**	**2007**	**2006**
Revenue:				
Products	$ 631,058	$ 511,692	$ 1,745,398	$ 1,500,180
Services	205,552	168,669	610,611	521,984
Total revenues	836,610	680,361	2,356,009	2,022,164
Costs and expenses	744,870	603,734	2,140,806	1,808,664
Operating income	91,740	76,627	215,203	213,500
Interest income	574	370	1,513	868
Interest and related expenses	27,401	30,268	84,217	90,789
Other (income) expense, net	(328)	(71)	(41)	1
Earnings before non-controlling interests and income taxes	65,241	46,800	132,540	123,578
Non-controlling interests	324	131	1,403	1,089
Earnings before income taxes	64,917	46,669	131,137	122,489
Income taxes	22,296	11,575	43,832	40,906
Net earnings	$ 42,621	$ 35,094	$ 87,305	$ 81,583
Net earnings per share of common stock:				
Basic earnings per share:	$ 1.05	$ 0.88	$ 2.15	$ 2.05
Diluted earnings per share:	$ 1.03	$ 0.86	$ 2.11	$ 2.01
Dividends per common share	$ 0.03	$ 0.03	$ 0.09	$ 0.09

See accompanying Notes to Consolidated Financial Statements.

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(in thousands)

(Unaudited)

	Nine Months Ended December 31,	
	2007	**2006**
Cash Flows from Operating Activities		
Net earnings	$ 87,305	$ 81,583
Adjustments to reconcile net earnings to cash flows from operating activities:		
Depreciation and amortization	57,263	57,122
Share-based compensation	8,930	8,224
Deferred income taxes	4,946	2,959
Thermal Weapon Sight II charge (Note 5.)	36,844	
Inventory reserve and provision for doubtful accounts	1,976	963
Amortization and write-off of deferred financing fees	4,708	4,419
Pension plan curtailment gain	(11,719)	
Other, net	1,584	(150)
Changes in assets and liabilities, net of effects from business combinations:		
Decrease (increase) in accounts receivable	4,220	(69,498)
Increase in inventories	(87,561)	(44,252)
(Increase) decrease in prepaid expenses and other current assets	(7,405)	13,863
(Decrease) increase in accounts payable	(12,002)	3,254
Decrease in accrued expenses and other current liabilities	(12,939)	(6,806)
Increase in customer advances	45,395	7,619
(Decrease) increase in pension and postretirement benefit liabilities	(5,690)	973
Other, net	2,666	1,381
Net cash provided by operating activities	118,521	61,654
Cash Flows from Investing Activities		
Capital expenditures	(48,790)	(38,113)
Payments pursuant to business combinations, net of cash acquired		(9,761)
Disposition of property, plant and equipment	410	348
Other, net		60
Net cash used in investing activities	(48,380)	(47,466)
Cash Flows from Financing Activities		
Borrowings on revolving line of credit	300,000	385,500
Repayments of revolving line of credit	(300,000)	(355,500)
Borrowings of long-term debt		459
Repayments of long-term debt	(129,098)	(3,423)
Excess tax benefit realized from share-based payment arrangements	4,274	2,258
Proceeds from stock option exercises	9,998	8,517
Dividends paid	(3,689)	(3,619)
Other	490	245
Net cash (used in) provided by financing activities	(118,025)	34,437
Effect of exchange rates on cash and cash equivalents	236	(367)
Net (decrease) increase in cash and cash equivalents	(47,648)	48,258

	Nine Months Ended December 31,	
Cash and cash equivalents, beginning of period	95,833	1,293
Cash and cash equivalents, end of period	$ 48,185	$ 49,551

See accompanying Notes to Consolidated Financial Statements.

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(Unaudited)

1. Description of Business

DRS Technologies, Inc., its wholly-owned subsidiaries and its controlling interests (hereinafter, DRS or the Company) is a supplier of defense electronic products, systems and military support services. The Company provides high-technology products and services to all branches of the U.S. military, major aerospace and defense prime contractors, government intelligence agencies, international military forces and industrial markets. The Company focuses on several key areas of importance for the U.S. Department of Defense (DoD), such as intelligence, surveillance, reconnaissance, power management, advanced communications and network systems. DRS is a provider of thermal imaging devices, combat display workstations, electronic sensor systems, power systems, battlefield digitization systems, air combat training systems, mission recorders, deployable flight incident recorders, environmental and telecommunication systems, aircraft loaders, military trailers and shelters. The Company also provides support services, including security and asset protection system services, telecommunication and information technology services, training and logistics support services for all branches of the U.S. armed forces, and certain foreign militaries, homeland security forces and selected government and intelligence agencies.

2. Basis of Presentation

The accompanying unaudited consolidated financial statements include all wholly-owned and majority-owned subsidiaries and controlling interests of DRS. The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of the Company, the interim consolidated financial information provided herein reflects all adjustments (consisting of normal and recurring adjustments) necessary for a fair presentation of the Company's consolidated financial position as of December 31, 2007, the results of its operations for the three- and nine-month periods ended December 31, 2007 and 2006, and its cash flows for the nine-month periods ended December 31, 2007 and 2006. The results of operations and cash flows for the interim period ended December 31, 2007 are not necessarily indicative of the results to be expected for the full year. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements of the Company for the fiscal year ended March 31, 2007, which are included in the Company's filing on Form 10-K for the year ended March 31, 2007.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and costs and expenses during the reporting period. The most significant of these estimates and assumptions relate to contract revenue, costs to complete performance on a contract, profit and loss recognition, fair values of assets acquired and liabilities assumed in business combinations, market values for inventories reported at lower of cost or market, pension and postretirement benefit obligations, share-based employee compensation costs, recoverability, useful lives and valuation of recorded amounts of long-lived assets, identifiable intangible assets and goodwill, income taxes, including the valuation of deferred tax assets, litigation reserves and environmental obligations. Changes in estimates are reflected in the periods during which they become known. Actual amounts will differ from these estimates and could differ materially. For a more complete discussion of these estimates and assumptions, see the Annual Report of DRS Technologies, Inc. on Form 10-K for the fiscal year ended March 31, 2007.

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

2. Basis of Presentation (Continued)

The fiscal year-end consolidated balance sheet data was derived from the Company's audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. Certain fiscal 2007 amounts have been reclassified to conform to the fiscal 2008 presentation.

3. Income Taxes

The provision for income taxes for the three- and nine-month periods ended December 31, 2007 reflected an effective income tax rate of approximately 34.3% and 33.4%, respectively, as compared with 24.8% and 33.4%, respectively, for the same periods last year. The Company's effective rate for the third quarter includes $1.0 million of discrete tax benefits compared to $5.5 million in the comparable quarter from the prior year. The discrete cumulative benefit in the third quarter of the prior year is related to an Extraterritorial Income Exclusion benefit.

In July 2006, the Financial Accounting Standard's Board (FASB) issued FASB Interpretation No. 48 (FIN 48). FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. FIN 48 states that a tax benefit from an uncertain tax position may be recognized only if it is "more likely than not" that the position is sustainable, based on its technical merits. The tax benefit of a qualifying position is the largest amount of tax benefit that is greater than 50% likely of being realized upon settlement with a taxing authority having full knowledge of all relevant information. A tax benefit from an uncertain tax position was recognized previously if it was "probable" of being sustained. Under FIN 48, the liability for unrecognized tax benefits is classified as noncurrent, unless the liability is expected to be settled in cash within 12 months of the reporting date. The Company adopted the provisions of FIN 48 on April 1, 2007. The impact of adopting FIN 48 on the Company's consolidated financial statements is summarized below.

	Balance at March 31, 2007	FIN 48 Reclassification	Balance at April 1, 2007
		(in thousands)	
Accrued interest	$ 25,608	$ 5,801	$ 31,409
Income taxes payable	$ 51,470	$ (8,243)	$ 43,227
Deferred tax assets	$ 26,451	$ 4,932	$ 31,383
Other liabilities	$ 158,682	$ 7,374	$ 166,056
Retained earnings	$ 399,793	$	$ 399,793

The Company operates in multiple taxing jurisdictions, both within the United States and outside of the United States, and faces audits from various tax authorities regarding transfer pricing, equity related payroll deductions, the deductibility of certain expenses and intercompany transactions, as well as other matters. At April 1, 2007, the total amount of liability for unrecognized tax benefits related to federal, state and foreign taxes was approximately $38.0 million (of which approximately $5.3 million would impact the Company's effective tax rate if recognized) plus accrued interest of $5.8 million. As of December 31, 2007, the corresponding balance for unrecognized tax benefits was approximately $21.0 million (of which approximately $6.1 million would impact the Company's effective tax rate if recognized) for the items described above plus approximately $4.6 million of accrued interest. The reduction of approximately $17.0 million in the unrecognized tax benefit for the nine months ended

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

3. Income Taxes (Continued)

December 31, 2007 relates primarily to the Engineered Support Systems, Inc. (ESSI) tax settlement (See Note 15) of which $12.8 million was paid to or applied to refunds due from taxing authorities and $4.1 million was reversed through goodwill with the remaining amount reducing income tax expense in the consolidated statement of earnings.

The Company is currently under examination in several tax jurisdictions and remains subject to examination until the statute of limitations expires for the respective tax jurisdiction. Within specific countries, the Company may be subject to audit by various tax authorities, or subsidiaries operating within the country may be subject to different statute of limitations expiration dates. As of December 31, 2007, a summary of the tax years that remain subject to examination in the Company's major tax jurisdictions are:

United States Federal	March 31, 2002 and forward
United States States	March 31, 2002 and forward
Germany	December 31, 2002 and forward
United Kingdom	December 31, 2003 and forward
Canada	October 31, 2003 and forward
Canada Provinces	December 31, 2001 and forward

Based upon the expiration of statutes of limitations and/or the anticipated conclusion of tax examinations in several jurisdictions, the Company believes it reasonably possible that the total amount of liability for unrecognized tax benefits for the items discussed above may decrease by up to $5.1 million within 12 months of December 31, 2007.

The Company's policy is to classify penalties related to unrecognized tax benefits as income tax expense. The Company's policy is to classify interest related to unrecognized tax benefits as interest expense. In fiscal 2007 and prior, these amounts were classified as income tax expense.

4. Share-Based Compensation

The Company recorded total share-based costs related to stock options and non-vested stock of $3.8 million and $10.4 million for the three- and nine-month periods ended December 31, 2007, respectively, and $2.8 million and $8.9 million for the three- and nine-month periods ended December 31, 2006, respectively. Such amounts were recognized in the consolidated financial statements as follows:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2007	**2006**	**2007**	**2006**
	(in thousands)			
Total cost of share-based payment plans	$ 3,811	$ 2,833	$ 10,367	$ 8,883
Amounts capitalized in inventory	(2,350)	(1,619)	(6,065)	(3,891)
Amounts charged against earnings for amounts previously capitalized in inventory	2,340	1,442	4,628	3,232
Amounts charged against earnings before income tax benefit	$ 3,801	$ 2,656	$ 8,930	$ 8,224

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

4. Share-Based Compensation (Continued)

Stock Options The following table summarizes information regarding the Company's stock option activity and amounts as of and for the nine months ended December 31, 2007.

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (in thousands)
Outstanding at March 31, 2007	2,394,314	$ 32.04		
Granted	249,469	$ 53.67		
Exercised	(447,546)	$ 22.34		
Cancelled/forfeited	(23,873)	$ 33.87		
Outstanding at December 31, 2007	2,172,364	$ 36.50	6.26	$ 38,601
Vested and expected to vest at December 31, 2007(1)	2,157,425	$ 36.41	6.25	$ 38,528
Exercisable at December 31, 2007	1,590,742	$ 32.98	5.54	$ 33,860

(1) Represents outstanding options reduced by expected forfeitures.

The aggregate intrinsic values, disclosed in the table above, represent the difference between DRS's closing stock price on the last trading day of the third quarter (December 31, 2007) and the exercise price, multiplied by the number of in-the-money stock options for each category.

The total intrinsic values of stock options exercised, based on the difference between DRS's stock price at the time of exercise and the related exercise price, during the nine-month periods ended December 31, 2007 and 2006 was $14.8 million and $9.5 million, respectively. Total compensation cost related to stock options was $1.4 million and $4.3 million for the three- and nine-month periods ended December 31, 2007, respectively, and $1.2 million and $5.0 million for the three- and nine-month periods ended December 31, 2006, respectively. At December 31, 2007, unrecognized compensation costs related to stock options was $8.6 million ($5.4 million after income taxes), which is expected to be recognized over a weighted average remaining period of 2.6 years.

The estimated weighted average grant date fair value of each stock option awarded was $20.99 for the nine-month period ended December 31, 2007, and $16.41 and $21.44 for the three- and nine-month periods ended December 31, 2006, respectively. There were no stock option grants for the three-month period ended December 31, 2007.

Stock Option Fair Value Estimation Assumptions For purposes of estimating the fair value provisions of Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004) "Share-Based Payment" (SFAS 123R), the Company estimates the fair value of its stock options at the date of grant using the Black-Scholes option-pricing valuation model. The Company's valuation model is impacted by DRS's stock price, as well as weighted average assumptions for a number of subjective variables described below.

Expected Holding Period The expected holding period of stock options granted represents the period of time that stock options granted are expected to be outstanding until they are

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DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

4. Share-Based Compensation (Continued)

exercised, cancelled or forfeited. The Company uses historical information to estimate stock option exercise data and employee terminations within the valuation model.

Expected Volatility Expected volatility is based on historical daily volatility of DRS common stock over the expected holding period.

Expected Dividend Yield Expected dividend yield is based on DRS's expected dividend payments relative to the current market price of DRS common stock.

Risk-Free Interest Rate The risk-free interest rate for stock options is based on the U.S. Treasury yield curve in effect at the time of grant for maturities similar to the expected holding period of the stock options.

Forfeiture Rate The forfeiture rate is based on the historical forfeiture experience and prospective analysis of different pools of employees. We monitor share option exercise and employee termination patterns of each pool to estimate forfeiture rates within the valuation model.

Changes in assumptions can materially impact the estimated fair value of stock options. The weighted average assumptions used in the Company's valuation model are presented in the table below.

	Nine Months Ended December 31, 2007
Expected holding period (in years)	5.5
Expected volatility	33.61%
Expected dividend yield	0.23%
Risk-free interest rate	4.93%
Weighted-average fair value of options granted	$ 20.99

Non-Vested Stock and Non-Vested Stock Units Non-vested stock is granted to certain employees, as permitted under the 2006 Omnibus Plan in the name of the employee, who has all the rights of a stockholder, subject to certain restrictions. Non-vested stock units are granted in the name of the employee; however, the participant has no rights as a stockholder. These non-vested stock units are redeemed for DRS common stock once a three-year cliff vesting period has been satisfied. The cost of the grants, as determined by the market prices of the common stock at the grant dates, net of expected forfeitures, is recognized over the vesting periods.

Compensation cost for non-vested stock awards for the three months ended December 31, 2007 and 2006 was $2.4 million and $1.6 million, respectively, and $6.1 million and $3.9 million for the nine months ended December 31, 2007 and 2006, respectively. As of December 31, 2007, total unrecognized compensation costs related to non-vested stock awards was $19.1 million ($12.2 million after income taxes), and that amount is expected to be recognized over a weighted average remaining period of 2.1 years.

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

4. Share-Based Compensation (Continued)

The following table details the activity in non-vested stock awards for the nine months ended December 31, 2007.

	Nine Months Ended December 31, 2007	
	Number of Shares	**Weighted Average Grant Date Fair Value per Share**
Nonvested Balance at March 31, 2007	362,396	$ 49.86
Granted	285,814	$ 54.27
Vested	(2,000)	$ 27.79
Forfeited/cancelled	(39,538)	$ 51.23
Nonvested Balance at December 31, 2007	606,672	$ 51.93

5. Inventories

Inventories are summarized as follows:

	December 31, 2007	March 31, 2007
	(in thousands)	
Work-in-process	$ 511,205	$ 466,221
General and administrative costs	72,186	64,229
Raw material and finished goods	59,282	53,158
	642,673	583,608
Less: Progress payments and certain customer advances	212,013	206,746
Inventory reserve	9,925	9,250
Total	$ 420,735	$ 367,612

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

The table below presents a summary of G&A, IRAD and B&P costs included in inventoried contract costs and changes to them, including amounts used in the determination of costs and expenses. The cost data in the table below does not include the G&A, IRAD and B&P costs for the Company's lines of businesses that are not primarily contracted with the U.S. government, which are expensed as incurred.

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2007	**2006**	**2007**	**2006**

	Three Months Ended December 31,		Nine Months Ended December 31,	
	(in thousands)			
Balance in inventory at beginning of period	$ 70,817	$ 65,223	$ 64,229	$ 63,836
Add: Incurred costs	112,182	91,877	301,504	266,938
Less: Amounts included in costs and expenses	(110,813)	(90,810)	(293,547)	(264,484)
Balance in inventory at end of period	$ 72,186	$ 66,290	$ 72,186	$ 66,290

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

5. Inventories (Continued)

Total expenditures for IRAD amounted to approximately $14.9 million and $12.6 million for the three-month periods ended December 31, 2007 and 2006, respectively, and $40.4 million and $37.9 million, respectively, for the nine-month periods then ended.

During the first quarter of fiscal 2008, the Company recorded a $36.8 million charge to operations for an anticipated loss on the Thermal Weapon Sight II (TWS II) program. The charge reflected the cost of procuring new material following design modifications, as well as the write-off of certain obsolete inventory. As a result of the design changes, the Company also transferred $30.0 million of saleable product and components from the TWS II program (transferred inventory) to inventory during the first quarter of fiscal 2008, which is valued at the lower of cost or market as of December 31, 2007. The Company believes that the transferred inventory will be sold primarily through international distribution channels. The sale of certain products outside of the United States is highly regulated and any inability to obtain the requisite licenses or comply with applicable government export regulations may affect the Company's ability to export the transferred inventory. If the Company is precluded from selling the transferred inventory to certain international customers and/or is unable to generate sufficient domestic revenues, the value of the transferred inventory may be required to be written down or written off in a future period. Such a write-down or write-off could be material to the results of operations in any one period. During the third quarter of fiscal 2008, the Company received an order for $5.3 million of thermal weapon sights that will be shipped out of the transferred inventory. As of December 31, 2007, approximately $21.5 million of transferred inventory and components remained with the Company.

6. Goodwill and Intangible Assets

The table below reconciles the change in the carrying amount of goodwill by operating segment for the period from March 31, 2007 to December 31, 2007.

	C4I	RSTA	Sustainment Systems	Technical Services	Total
			(in thousands)		
Balance as of March 31, 2007	$ 654,446	$ 176,376	$ 1,040,605	$ 745,215	$ 2,616,642
ESSI tax settlements			(2,297)	(1,228)	(3,525)
Codem Systems, Inc. acquisition earn-out	2,638				2,638
Night Vision Systems, Inc. earn-out		3,738			3,738
Walkabout Computer Systems, Inc. acquisition earn-out	238				238
Power Technologies, Inc. earn-out	2,000				2,000
Transfer of operating unit(A)			12,118	(12,118)	
Other	(390)				(390)
Foreign currency translation adjustment	3,632		1,166		4,798
Balance as of December 31, 2007	$ 662,564	$ 180,114	$ 1,051,592	$ 731,869	$ 2,626,139

(A) On October 1, 2007, the ESSIBuy operating unit, an operating unit of the Technical Services Segment, was consolidated into an operating unit of the Sustainment Systems Segment to achieve certain operating synergies. The goodwill adjustment was considered immaterial for purposes of restating prior-period goodwill balances for both the Sustainment Systems and Technical Services Segments.

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

6. Goodwill and Intangible Assets (Continued)

The following disclosure presents certain information regarding the Company's acquired intangible assets as of December 31, 2007 and March 31, 2007. All acquired intangible assets are being amortized over their estimated useful lives, as indicated below, with no estimated residual values.

Acquired Intangible Assets	Weighted Average Amortization Period	Gross Carrying Amount	Accumulated Amortization	Net Balance
			(in thousands)	
As of December 31, 2007				
Technology-based intangibles	18 years	$ 47,859	$ (19,202)	$ 28,657
Customer and program/contract-related intangibles	11 years	214,612	(68,152)	146,460
Total		$ 262,471	$ (87,354)	$ 175,117
As of March 31, 2007				
Technology-based intangibles	18 years	$ 47,859	$ (17,016)	$ 30,843
Customer and program/contract-related intangibles	11 years	214,439	(48,298)	166,141
Total		$ 262,298	$ (65,314)	$ 196,984

The aggregate acquired intangible asset amortization expense for the three-month periods ended December 31, 2007 and 2006 was $7.3 million and $7.9 million, respectively, and for the nine-month periods ended December 31, 2007 and 2006 was $22.0 million and $23.3 million, respectively. The estimated acquired intangible asset annual amortization expense is expected to be approximately $29.2 million for fiscal year 2008, $29.2 million for fiscal year 2009, $28.3 million for fiscal year 2010, $27.5 million for fiscal year 2011 and $14.0 million for fiscal year 2012.

The Company's goodwill and intangible assets are more fully described in Note 3 to the Company's consolidated financial statements for the year ended March 31, 2007.

7. Product Warranties

Product warranty costs generally are accrued when the covered products are delivered to the customer. Product warranty costs are recognized based on the terms of the product warranty and the related estimated costs, considering historical claims expense. Accrued warranty costs are reduced as these costs are incurred and as the warranty period expires, and otherwise may be modified as specific product performance issues are identified and resolved. The table below presents the changes in the Company's accrual for product warranties for the nine months ended December 31, 2007 and 2006, which are included in accrued expenses and other current liabilities.

	Nine Months Ended December 31,	
	2007	2006
	(in thousands)	
Balance at beginning of period	$ 31,180	$ 29,829

	Nine Months Ended December 31,	
Acquisitions during the period		932
Accruals for product warranties issued during the period	18,848	17,035
Settlements made during the period	(12,824)	(14,501)
Other	(262)	68
Balance at end of the period	$ 36,942	$ 33,363

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

8. Debt

	December 31, 2007	March 31, 2007
	(in thousands)	
Credit Facility:		
Revolving line of credit	$	$
Term loan	145,187	272,250
Canadian Term Loan	8,148	8,479
6 5/8% Senior Notes due 2016	350,000	350,000
7 5/8% Senior Subordinated Notes due 2018	250,000	250,000
6 7/8% Senior Subordinated Notes due 2013	550,000	550,000
2.0% Convertible Senior Notes due 2026	345,000	345,000
Unamortized bond premium on 6 7/8% Senior Subordinated Notes	6,605	7,453
Other obligations	4,913	5,025
	1,659,853	1,788,207
Less:		
Current installments of long-term debt	5,518	5,161
Total long-term debt	$ 1,654,335	$ 1,783,046

The weighted average interest rate on the Company's term loan borrowings under its Credit Facility was 6.5% as of December 31, 2007 (6.9% as of March 31, 2007). At December 31, 2007 and March 31, 2007, there were no outstanding revolving line of credit borrowings against the Credit Facility.

From time to time, the Company enters into standby letters-of-credit and bank guarantee agreements with financial institutions and customers, primarily relating to the guarantee of its future performance on certain contracts to provide products and services and to secure advance payments it has received from its customers. As of December 31, 2007, $32.7 million was contingently payable under letters of credit and bank guarantees. Of this amount, approximately $0.9 million and $0.3 million in letters of credit and bank guarantees, respectively, were issued under a previous credit agreement and by a bank agreement for the Company's U.K. subsidiary, respectively, and are not considered when determining the availability under the Company's revolving line of credit. At December 31, 2007, the Company had $368.5 million of availability under its revolving line of credit.

During the nine months ended December 31, 2007, the Company prepaid at its discretion $125.0 million of the outstanding term loan with proceeds from the Company's revolving line of credit and recognized a $0.3 million charge to interest and related expenses.

On March 29, 2006, DRS Technologies Canada Company (DRS Canada) established a five-year senior secured term loan (Canadian Term Loan) for approximately $9.9 million (C$11.5 million), maturing on April 1, 2011. The weighted average interest rate on the term loan was 6.0% as of December 31, 2007 (6.0% as of March 31, 2007). The carrying value of the Canadian Term Loan increased $1.3 million during the nine months ended December 31, 2007, as a result of the strengthening of the Canadian dollar compared to the U.S. dollar during that period.

Accrued interest expense at December 31, 2007 and March 31, 2007 was $27.8 million and $25.6 million, respectively.

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

8. Debt (Continued)

Certain of the Company's debt arrangements contain customary representations, warranties and default provisions, as well as restrictions that, among other things, limit the amount of debt that the Company may have outstanding. As of December 31, 2007, the Company was in compliance with all covenants.

In January 2006, in connection with the offering of the Company's 2% Convertible Notes due 2026 (Convertible Notes), the Company entered into a registration rights agreement relating to the Company's Common Stock issuable upon conversion of the Convertible Notes. Pursuant to the registration rights agreement, if the Company does not file a prospectus supplement or shelf registration statement relating to the resale of the Common Stock within certain specified time periods or maintain the effectiveness of a registration statement related to the resale of the Common Stock, subject to certain exceptions, the Company could be subject to additional interest. The Company believes the likelihood of occurrence of such event is remote and, therefore, the Company has not recorded a liability at December 31, 2007. In the event that it becomes probable that the Company would have to pay additional interest under the registration rights agreement, the Company estimates the maximum potential amount as of December 31, 2007 to be approximately $3.5 million per year.

The Company's indebtedness is more fully described in Note 8 to the Company's Consolidated Financial Statements for the year ended March 31, 2007.

9. Earnings per Share

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2007	2006	2007	2006
	(in thousands, except per-share data)			
Basic EPS computation				
Net earnings	$ 42,621	$ 35,094	$ 87,305	$ 81,583
Weighted average common shares outstanding	40,676	39,879	40,528	39,742
Basic earnings per share	$ 1.05	$ 0.88	$ 2.15	$ 2.05
Diluted EPS computation				
Net earnings	$ 42,621	$ 35,094	$ 87,305	$ 81,583
Diluted common shares outstanding				
Weighted average common shares outstanding	40,676	39,879	40,528	39,742
Stock options and non-vested awards	793	861	833	932
Diluted common shares outstanding	41,469	40,740	41,361	40,674
Diluted earnings per share	$ 1.03	$ 0.86	$ 2.11	$ 2.01

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

9. Earnings per Share (Continued)

At December 31, 2007 and 2006, there were 423,843 and 401,716 options to acquire DRS common stock outstanding, respectively, that are excluded from the above calculation because their inclusion would have had an antidilutive effect on EPS in their respective fiscal years.

For the three- and nine-month periods ended December 31, 2007 and 2006, DRS's 2% Convertible Senior Notes due 2026 had no impact on diluted EPS because the average stock price during such periods was below $59.70 per share.

10. Comprehensive Earnings

The components of comprehensive earnings for the three- and nine-month periods ended December 31, 2007 and 2006 consisted of the following:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2007	2006	2007	2006
	(in thousands)			
Net earnings	$ 42,621	$ 35,094	$ 87,305	$ 81,583
Other comprehensive earnings:				
Foreign currency translation adjustments	(602)	(1,047)	6,211	1,534
Minimum pension liability, net of income taxes	92	(251)	1,345	(908)
Unrealized net gains on hedging instruments arising during the period, net of income tax				(20)
Comprehensive earnings	$ 42,111	$ 33,796	$ 94,861	$ 82,189

11. Pensions and Other Employee Benefits

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106 and 132(R)" (SFAS 158). The Company adopted the recognition provisions of SFAS 158 in its Consolidated Financial Statements at March 31, 2007. See Note 12 to the Company's audited Consolidated Financial Statements for the year ended March 31, 2007, included in the Company's Annual Report on Form 10-K for a discussion of the recognition provisions of SFAS 158. In addition, SFAS 158 requires companies to measure pension and postretirement benefit plan assets and benefit obligations as of the date of the employer's fiscal year end balance sheet. The Company will be required to change the measurement date from December 31 to March 31 for its pension and postretirement plans in the fiscal year beginning April 1, 2008. The Company currently is evaluating the impact of the change in the measurement date on the Company's results of operations.

On June 29, 2007, the Company approved and adopted an amendment to one of its defined benefit pension plans to cease the accrual of future benefits effective December 31, 2007. All retirement benefits earned by employees enrolled in the plan as of December 31, 2007 are fully preserved. Such employees' ongoing service with the Company will continue to be credited for vesting purposes. The amendment of the defined benefit pension plan was accounted for as a plan curtailment, and, as a result, the Company recorded a gain of $11.7 million during the second quarter of fiscal 2008.

The following table summarizes the components of net periodic benefit cost for the Company's pension and postretirement benefit plans for the three- and nine-month periods ended December 31,

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

11. Pensions and Other Employee Benefits (Continued)

2007 and 2006. These plans are more fully described in Note 12 to the Company's Consolidated Financial Statements for the year ended March 31, 2007.

	Funded Pension Plans		Postretirement Benefit Plans		Unfunded Supplemental Retirement Plans	
	Three Months Ended December 31,					
	2007	2006	2007	2006	2007	2006
	(in thousands)					
Service cost	$ 1,955	$ 1,834	$ 120	$ 146	$ 146	$ 143
Interest cost	3,526	3,243	332	320	361	318
Expected return on plan assets	(4,065)	(3,490)	(62)	(56)		
Amortization of unrecognized loss (gain)	58	117	(35)	(8)	41	47
Amortization of transition obligation			28	28		
Amortization of unrecognized prior-service cost	3	39	(6)	(6)	194	194
Net periodic benefit cost	$ 1,477	$ 1,743	$ 377	$ 424	$ 742	$ 702

	Funded Pension Plans		Postretirement Benefit Plans		Unfunded Supplemental Retirement Plans	
	Nine Months Ended December 31,					
	2007	2006	2007	2006	2007	2006
	(in thousands)					
Service cost	$ 5,411	$ 5,503	$ 360	$ 437	$ 438	$ 429
Interest cost	10,832	9,728	996	959	1,082	955
Expected return on plan assets	(12,194)	(10,470)	(186)	(169)		
Amortization of unrecognized loss (gain)	262	350	(105)	(25)	123	141
Amortization of transition obligation			84	84		
Amortization of unrecognized prior-service cost	9	117	(18)	(18)	582	583
Curtailment gain	(11,719)					
Net periodic benefit (income) cost	$ (7,399)	$ 5,228	$ 1,131	$ 1,268	$ 2,225	$ 2,108

The Company expects to contribute $15.9 million and $1.6 million to its pension and postretirement plans, respectively, during the fiscal year ended March 31, 2008, of which $12.1 million and $1.2 million, respectively, were contributed during the nine-month period ended December 31, 2007.

12. Operating Segments

The Company's four principal operating segments, on the basis of products and services offered are: the Command, Control, Communications, Computers and Intelligence (C4I) Segment, the Reconnaissance, Surveillance & Target Acquisition (RSTA) Segment, the Sustainment Systems Segment and the Technical Services Segment. All other operations, primarily our Corporate Headquarters, are grouped in Other.

The C4I Segment is comprised of the following business areas: Command, Control & Communications, which includes naval display systems, ship communications systems, radar systems, technical support, electronic manufacturing and system integration services, secure voice and data

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

12. Operating Segments (Continued)

communications, air combat training, electronic warfare and ship network systems; Power Systems, which includes naval and industrial power generation, conversion, propulsion, distribution and control systems; Intelligence Technologies, which includes signals intelligence, communications intelligence, data collection, processing and dissemination equipment, high-speed digital data and imaging systems, unmanned vehicles, and mission and flight recorders; Tactical Systems, which includes battle management tactical computer systems, peripherals, electronic test, diagnostics and vehicle electronics; and Homeland Security, which includes integration of traditional security infrastructures into a single, comprehensive border security suite for the Department of Homeland Security.

The RSTA Segment develops and produces electro-optical sighting, targeting and weapon sensor systems, and image intensification (I^2) night vision, combat identification and laser aimers/illuminator products, and provides electronic manufacturing services.

The Sustainment Systems Segment designs, engineers and manufactures integrated military electronics and other military support equipment, primarily for the DoD, as well as related heat transfer and air handling equipment, and power generation and distribution equipment for domestic commercial and industrial users. The segment provides these systems for military, humanitarian, disaster recovery and emergency responder applications.

The Technical Services Segment provides engineering services, logistics and training services, advanced technology services, security and asset protection systems and services, telecommunication systems, integration and information technology services, power generation and vehicle armor kits. The segment provides these services for military, intelligence, humanitarian, disaster recovery and emergency responder applications.

Other includes the activities of DRS Corporate Headquarters and certain non-operating subsidiaries of the Company.

On October 1, 2007, the ESSIBuy operating unit, an operating unit of the Technical Services Segment, was consolidated into an operating unit of the Sustainment Systems Segment to achieve certain operating synergies. The balance sheet and operating results of ESSIBuy were reclassified for the period from April 1, 2007 through September 30, 2007. The results in the prior-year were not reclassified, as they were considered immaterial to both segments.

Transactions between segments generally are negotiated and accounted for under terms and conditions that are similar to other government and commercial contracts; however, these intercompany transactions are eliminated in consolidation. The Company evaluates segment-level performance based on revenues and operating income, as presented in the Consolidated Statements of Earnings. Operating

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

12. Operating Segments (Continued)

income, as shown, includes amounts allocated from DRS Corporate operations using an allocation methodology prescribed by U.S. government regulations for government contractors.

	C4I	RSTA	Sustainment Systems	Technical Services	Other	Total
			(in thousands)			
Three Months Ended December 31, 2007						
Total revenues	$ 337,067	$ 207,183	$ 131,251	$ 167,537	$	$ 843,038
Intersegment revenues	(3,654)	(489)	(1,622)	(663)		(6,428)
External revenues	$ 333,413	$ 206,694	$ 129,629	$ 166,874	$	$ 836,610
Operating income (loss)	$ 39,019	$ 25,143	$ 15,154	$ 12,652	$ (228)	$ 91,740
Total assets	$ 1,317,120	$ 470,014	$ 1,316,932	$ 967,230	$ 152,211	$ 4,223,507
Depreciation and amortization	$ 6,776	$ 3,376	$ 4,505	$ 3,807	$ 1,439	$ 19,903
Capital expenditures	$ 6,512	$ 4,816	$ 1,193	$ 2,294	$ 1,478	$ 16,293
Three Months Ended December 31, 2006						
Total revenues	$ 268,816	$ 167,910	$ 104,004	$ 152,409	$	$ 693,139
Intersegment revenues	(763)	(1,124)	(8,010)	(2,881)		(12,778)
External revenues	$ 268,053	$ 166,786	$ 95,994	$ 149,528	$	$ 680,361
Operating income (loss)	$ 27,669	$ 20,588	$ 17,039	$ 11,390	$ (59)	$ 76,627
Total assets	$ 1,245,035	$ 464,241	$ 1,300,872	$ 988,539	$ 165,954	$ 4,164,641
Depreciation and amortization	$ 6,015	$ 3,379	$ 4,840	$ 3,311	$ 1,214	$ 18,759
Capital expenditures	$ 4,750	$ 2,179	$ 1,629	$ 642	$ 1,695	$ 10,895
Nine Months Ended December 31, 2007						
Total revenues	$ 953,834	$ 552,872	$ 368,489	$ 513,895	$	$ 2,389,090
Intersegment revenues	(12,603)	(3,824)	(14,470)	(2,184)		(33,081)
External revenues	$ 941,231	$ 549,048	$ 354,019	$ 511,711	$	$ 2,356,009
Operating income (loss)	$ 105,007	$ 22,432	$ 51,108	$ 37,292	$ (636)	$ 215,203
Total assets	$ 1,317,120	$ 470,014	$ 1,316,932	$ 967,230	$ 152,211	$ 4,223,507
Depreciation and amortization	$ 18,810	$ 10,174	$ 13,271	$ 10,828	$ 4,180	$ 57,263
Capital expenditures	$ 20,511	$ 9,821	$ 4,559	$ 9,069	$ 4,830	$ 48,790
Nine Months Ended December 31, 2006						
Total revenues	$ 815,150	$ 433,975	$ 319,436	$ 504,909	$	$ 2,073,470

	C4I	RSTA	Sustainment Systems	Technical Services	Other	Total
Intersegment revenues	(3,406)	(3,825)	(39,109)	(4,966)		(51,306)
External revenues	$ 811,744	$ 430,150	$ 280,327	$ 499,943	$	$ 2,022,164
Operating income	$ 88,072	$ 46,412	$ 41,654	$ 36,578	$ 784	$ 213,500
Total assets	$ 1,245,035	$ 464,241	$ 1,300,872	$ 988,539	$ 165,954	$ 4,164,641
Depreciation and amortization	$ 18,790	$ 10,755	$ 13,424	$ 10,397	$ 3,756	$ 57,122
Capital expenditures	$ 18,270	$ 8,368	$ 4,262	$ 2,895	$ 4,318	$ 38,113

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

13. Supplemental Cash Flow Information

	Nine Months Ended December 31,	
	2007	2006
	(in thousands)	
Cash paid for:		
Interest	$ 78,664	$ 85,487
Income taxes	$ 44,708	$ 31,155
Supplemental disclosure of significant non-cash investing activities:		
Acquisition earn-out Night Vision Systems, Inc.	$ 3,738	$ 6,627
Acquisition earn-out Codem Systems, Inc.	$ 2,638	$
Acquisition earn-out Power Technology, Inc.	$ 2,000	$
Acquisition earn-out WalkAbout Computer Systems, Inc.	$ 238	$ 279
Contribution of fixed assets to joint venture	$ 429	$ 1,000
Fixed assets vouchered but not paid	$ 5,139	$

14. Cash Dividends on DRS Common Stock

On November 8, 2007, the Board of Directors declared a $0.03 per common share cash dividend, payable on December 31, 2007 to stockholders of record as of December 14, 2007. Cash dividends paid for the three- and nine-month periods ended December 31, 2007 were $1.2 million and $3.7 million, respectively. On February 7, 2008, the Board of Directors declared a $0.03 per common share cash dividend, payable on March 31, 2008 to stockholders of record as of March 14, 2008.

15. Contingencies

Various legal actions, claims, assessments and other contingencies, including certain matters described below, are pending against the Company and certain of the Company's subsidiaries. These matters are subject to many uncertainties, and it is possible that some of these matters ultimately could be decided, resolved or settled adversely. The Company had recorded accruals totaling $3.0 million at both December 31, 2007 and March 31, 2007 for losses related to those matters that the Company considers to be probable and that can be reasonably estimated (certain legal and environmental matters are discussed in detail below). Although, at December 31, 2007, the precise amount of liability that may result from those matters for which the Company has recorded accruals is not ascertainable, the Company believes that any amounts exceeding the Company's recorded accruals should not materially affect the Company's financial condition or liquidity. It is possible, however, that the ultimate resolution of those matters could result in a material adverse effect on the Company's results of operations and/or cash flows from operating activities for a particular reporting period.

Some environmental laws, such as the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (also known as CERCLA or the Superfund law) and similar state statutes, can impose liability for the entire cost of the clean up of contaminated sites upon any of the current or former site owners or operators (or upon parties who send waste to these sites), regardless of the lawfulness of the original activities that led to the contamination. In July 2000, prior to its acquisition by Integrated Defense Technologies Inc. (IDT) and prior to the Company's acquisition of IDT,

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

15. Contingencies (Continued)

Tech-Sym Corporation received a Section 104(e) Request for Information from the National Park Service (NPS), pursuant to CERCLA, regarding a site known as the Orphan Mine site in the Grand Canyon National Park, Arizona, which is the subject of an NPS investigation regarding the presence of residual radioactive materials and contamination. A corporation of which Tech-Sym is an alleged successor operated this uranium mine from 1956 to 1967 and owned it for the majority of such time. The Company believes that there are other potentially responsible parties (PRPs) for the environmental conditions at the site, including the U.S. government as owner, operator and arranger at the site. The potential liability associated with this matter can change substantially, due to such factors as additional information on the nature or extent of contamination, methods of remediation that might be recommended or required, changes in the apportionment of costs among the responsible parties and other actions by governmental agencies or private parties.

In connection with the Company's acquisition of ESSI in January 2006, the Company has been made aware of certain legal actions, claims, assessments and other contingencies, including those described below.

In December 2004, ESSI was notified by the Enforcement Division of the SEC of the issuance of a formal order directing a private investigation and was notified that the SEC had issued subpoenas to various individuals associated with ESSI to produce certain documents. The SEC staff also requested that ESSI produce certain documents in connection with the investigation. The subpoenas related to trading in ESSI stock around ESSI's earnings releases in 2003 and to the adequacy of certain disclosures made by ESSI regarding related-party transactions in 2002 and 2003 involving insurance policies placed by ESSI through an insurance brokerage firm in which an ESSI director was a principal at the time of the transactions. In February 2007, the SEC filed a civil injunctive action in the United States District Court for the Eastern District of Missouri, Eastern Division, against a former director, officer and consultant of ESSI, alleging that he had violated the federal securities laws by "tipping" his financial advisor and close friend by sharing material, nonpublic information regarding ESSI's financial condition shortly before certain 2003 earnings announcements.

On or about September 23, 2005, the SEC staff advised ESSI's counsel that it had issued a subpoena directed to ESSI and expanded its investigation to include ESSI's disclosure of a November 2004 stop work order relating to ESSI's Deployable Power Generation and Distribution Systems (DPGDS) program for the U.S. Air Force and relating to trading in ESSI stock by certain individuals associated with ESSI. In connection with the foregoing SEC investigation, ESSI and certain of its directors and officers have provided information and/or testimony to the SEC.

In January 2006, ESSI was informed that the Office of the U.S. Attorney for the Eastern District of Missouri was initiating an investigation into ESSI's disclosure of the DPGDS stop-work order and into trading in ESSI stock by ESSI insiders, which preceded such disclosure. The U.S. Attorney's office advised ESSI that, although it considered ESSI to be a subject of its investigation, ESSI was not a target. In connection with this investigation, the U.S. Attorney's office issued ESSI a subpoena requesting specified information, which ESSI has furnished.

In May 2006, the Company was advised that the Enforcement Division of the SEC and the U.S. Attorney's office each had expanded its investigation to include possible "backdating" of the timing of option grants at ESSI prior to the time ESSI was acquired by the Company. As a part of its

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

15. Contingencies (Continued)

investigation, the SEC issued subpoenas to certain former officers and employees of ESSI to provide testimony and produce certain documents.

In February 2007, the SEC filed civil injunctive actions in the United States District Court for the Eastern District of Missouri, Eastern Division, alleging that ESSI's former Chief Financial Officer and former Controller had each participated in a backdating scheme. Also in February 2007, the SEC reported that ESSI's former Controller had settled its action against him by consenting to disgorgement, financial penalties, an officer and director bar and a permanent suspension from practicing before the SEC as an accountant. In July 2007, the SEC filed civil injunctive actions in the United States District Court for the Eastern District of Missouri, Eastern Division, alleging that ESSI's former Chairman of the Board and Chief Executive Officer and his son (who was also a member of ESSI's Board of Directors and Compensation Committee) each participated in a backdating scheme.

In March 2007, ESSI's former Controller pleaded guilty to a one-count information brought by the office of the United States Attorney for the Eastern District of Missouri, charging him with making false statements to the government. In connection with his plea, this former ESSI executive admitted that a number of documents filed by ESSI with the SEC contained the materially false statement that the option price of shares subject to the ESSI stock option plan was the closing price of the stock on the date the options were awarded.

In March 2007, ESSI's former Chief Financial Officer was indicted by the grand jury of the United States District Court for the Eastern District of Missouri relating to the backdating of the timing of stock options at ESSI prior to the time ESSI was acquired by DRS. In July 2007, ESSI's former Chairman of the Board and Chief Executive Officer and his son (who was also a member of ESSI's Board of Directors and Compensation Committee) were each indicted on similar charges. The July 2007 superseding indictment charges these former ESSI officers and directors with twelve counts of fraud based on allegations that they backdated stock options on at least eight occasions between 1996 and 2002. The presiding judge has scheduled the criminal trial against these individuals to commence on September 2, 2008.

Although ESSI continues to be a subject of the U.S. Attorney's office's investigation, the U.S. Attorney's office has advised the Company that ESSI is not a target. Because the events being investigated occurred prior to the time of the Company's acquisition of ESSI, the U.S. Attorney's office has further advised the Company that it considers DRS to be a witness, not a subject or target of its investigation.

The Company is committed to full cooperation with regard to the foregoing investigations and proceedings. The Company is unable to determine at this time the impact, if any, these matters could have on the Company.

In September 2006, the Internal Revenue Service commenced an audit of ESSI's Federal tax returns for the tax periods ended October 31, 2004, October 31, 2005 and January 31, 2006. Thereafter, the Internal Revenue Service agreed, subject to Congressional approval, to close these audits based on ESSI's agreement to accept certain proposed adjustments (primarily involving the reversal of certain compensation deductions taken during these tax years) and a corresponding assessment of approximately $11.3 million (exclusive of interest), which was previously accrued. In September 2007,

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

15. Contingencies (Continued)

the Company received written confirmation from the Congressional Joint Committee on Taxation that it took no exception to the proposed adjustments.

In August 2007, a shareholder derivative complaint was filed in the United States District Court for the Eastern District of Missouri against ESSI's former Chairman of the Board and Chief Executive Officer, his son (who was also a member of ESSI's Board of Directors and Compensation Committee), ESSI's former Chief Financial Officer and ESSI's former Controller relating to the alleged backdating of stock options prior to ESSI's acquisition by DRS. The complaint also contains claims against each of the current members of DRS's Board of Directors relating to the alleged backdating of ESSI stock options and the ESSI acquisition. The Company believes the claims made against the current DRS Directors are without merit.

In January 2008, the Company received an inquiry from the Australian Competition and Consumer Commission (ACCC) related to one of its subsidiaries, DRS Training & Control Systems, Inc. The ACCC has requested documents and information regarding allegations of possible anticompetitive activity in violation of the Australian Trade Practices Act. The Company has commenced an internal investigation involving this matter, but currently is unable to determine the timing or the impact, if any, that the matter may have on the Company.

16. Related-Party Transactions

The Company currently leases a building in Oakland, New Jersey owned by LDR Realty Co., a partnership that was wholly owned, in equal amounts, by David E. Gross, DRS's co-founder and former President and Chief Technical Officer, and the late Leonard Newman, DRS's co-founder and former Chairman of the Board, Chief Executive Officer and Secretary and the father of Mark S. Newman, DRS's current Chairman of the Board, President and Chief Executive Officer. Following Leonard Newman's death in November 1998, Mrs. Ruth Newman, the wife of Leonard Newman and the mother of Mark S. Newman, succeeded to Leonard Newman's interest in LDR Realty Co. The lease agreement, with a monthly rental of $21.2 thousand, expired on April 30, 2007. The new lease commenced May 1, 2007 with the new monthly rental commencing on June 1, 2007 of $21.8 thousand for the first year with annual increases of approximately 3% every June 1. The lease expires August 31, 2010.

Skadden, Arps, Slate, Meagher & Flom LLP, a law firm to which a member of the Company's Board is of counsel, provided legal services to the Company during the nine months ended December 31, 2007 and 2006. Fees paid to Skadden, Arps, Slate, Meagher & Flom LLP for the nine months ended December 31, 2007 and 2006 were $1.3 million and $3.0 million, respectively.

In the fourth quarter of fiscal 2007, the stepson of Mark S. Newman, the Company's Chairman of the Board, President and Chief Executive Officer, commenced employment with Nemco Brokerage, Inc., a firm that has a longstanding relationship of providing insurance brokerage services to the Company and which receives commissions from third-party insurers based on policies it places on the Company's behalf.

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

17. Guarantor and Non-Guarantor Financial Statements

As presented in Note 8, "Debt," the Company has $350.0 million 6$^{5}/_{8}$% Senior Notes, $550.0 million 6$^{7}/_{8}$% Senior Subordinated Notes, $250.0 million 7$^{5}/_{8}$% Senior Subordinated Notes and $345.0 million 2% Convertible Senior Notes outstanding (collectively, the Notes). The Notes are fully and unconditionally guaranteed, jointly and severally, by the Company's wholly-owned domestic subsidiaries (the Guarantor Subsidiaries). The foreign subsidiaries and certain domestic subsidiaries of DRS (the Non-Guarantor Subsidiaries) do not guarantee the Notes.

The following condensed consolidating financial information in the Condensed Consolidating Balance Sheets as of December 31, 2007 and March 31, 2007, the Condensed Consolidating Statements of Earnings for the three- and nine-month periods ended December 31, 2007 and 2006, and the Condensed Consolidating Statements of Cash Flows for the nine-month periods ended December 31, 2007 and 2006 presents:

a) DRS Technologies, Inc. (the Parent),

b) the Guarantor Subsidiaries,

c) the Non-Guarantor Subsidiaries, and

d) DRS Technologies, Inc. on a consolidated basis.

The information includes elimination entries necessary to consolidate the Parent with the Guarantor and Non-Guarantor Subsidiaries.

The Guarantor and Non-Guarantor subsidiaries are presented on a combined basis. The principal elimination entries eliminate investments in subsidiaries and intercompany balances and transactions. Separate financial information for each of the Guarantor and Non-Guarantor Subsidiaries is not presented because management believes such financial statements would not be meaningful to investors.

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

17. Guarantor and Non-Guarantor Financial Statements (Continued)

Condensed Consolidating Balance Sheet
As of December 31, 2007
(in thousands)

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Assets					
Current assets					
Cash and cash equivalents	$ 28,760	$	$ 28,731	$ (9,306)	$ 48,185
Accounts receivable, net	4	498,332	33,836		532,172
Inventories, net		362,876	57,873	(14)	420,735
Prepaid expenses, deferred income taxes and other current assets	100,160	204,943	37,705	(205,401)	137,407
Intercompany receivables	2,105,329			(2,105,329)	
Total current assets	2,234,253	1,066,151	158,145	(2,320,050)	1,138,499
Property, plant and equipment, net	16,912	213,028	13,630		243,570
Acquired intangibles, net		174,532	585		175,117
Goodwill	24,115	2,553,957	48,067		2,626,139
Deferred income taxes and other noncurrent assets	41,986	74,839	12,133	(88,776)	40,182
Investment in subsidiaries	1,143,419	36,863	42	(1,180,324)	
Total assets	$ 3,460,685	$ 4,119,370	$ 232,602	$ (3,589,150)	$ 4,223,507
Liabilities and Stockholders' Equity					
Current liabilities					
Current installments of long-term debt	$ 2,750	$ 221	$ 2,547	$	$ 5,518
Accounts payable	5,554	243,802	37,694		287,050
Accrued expenses and other current liabilities	163,380	501,175	50,365	(205,404)	509,516
Intercompany payables		742,871	8,782	(751,653)	
Total current liabilities	171,684	1,488,069	99,388	(957,057)	802,084
Long-term debt, excluding current installments	1,644,041	3,057	7,237		1,654,335
Other liabilities	25,503	186,539	24,366	(88,777)	147,631
Total liabilities	1,841,228	1,677,665	130,991	(1,045,834)	2,604,050
Total stockholders' equity	1,619,457	2,441,705	101,611	(2,543,316)	1,619,457
	$ 3,460,685	$ 4,119,370	$ 232,602	$ (3,589,150)	$ 4,223,507

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Total liabilities and stockholders' equity					

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

17. Guarantor and Non-Guarantor Financial Statements (Continued)

Condensed Consolidating Balance Sheet
As of March 31, 2007
(in thousands)

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Assets					
Current assets					
Cash and cash equivalents	$ 92,795	$	$ 14,598	$ (11,560)	$ 95,833
Accounts receivable, net	4	504,188	31,050		535,242
Inventories, net		321,877	45,735		367,612
Prepaid expenses, deferred income taxes and other current assets	8,547	298,737	21,120	(201,429)	126,975
Intercompany receivables	2,051,028		24,115	(2,075,143)	
Total current assets	2,152,374	1,124,802	136,618	(2,288,132)	1,125,662
Property, plant and equipment, net	15,389	206,332	9,485		231,206
Acquired intangibles, net		196,488	496		196,984
Goodwill	24,115	2,549,258	43,269		2,616,642
Deferred income taxes and other noncurrent assets	196,737	2,292	7,227	(162,040)	44,216
Investment in subsidiaries	1,143,419	36,905		(1,180,324)	
Total assets	$ 3,532,034	$ 4,116,077	$ 197,095	$ (3,630,496)	$ 4,214,710
Liabilities and Stockholders' Equity					
Current liabilities					
Current installments of long-term debt	$ 2,750	$ 188	$ 2,223	$	$ 5,161
Accounts payable	11,022	253,796	32,609		297,427
Accrued expenses and other current liabilities	226,667	401,351	39,370	(199,444)	467,944
Intercompany payables		817,303	13,347	(830,650)	
Total current liabilities	240,439	1,472,638	87,549	(1,030,094)	770,532
Long-term debt, excluding current installments	1,771,953	3,242	7,851		1,783,046
Other liabilities	17,192	285,793	19,723	(164,026)	158,682
Total liabilities	2,029,584	1,761,673	115,123	(1,194,120)	2,712,260
Total stockholders' equity	1,502,450	2,354,404	81,972	(2,436,376)	1,502,450
Total liabilities and stockholders' equity	$ 3,532,034	$ 4,116,077	$ 197,095	$ (3,630,496)	$ 4,214,710

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DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

17. Guarantor and Non-Guarantor Financial Statements (Continued)

Condensed Consolidating Statements of Earnings
Three Months Ended December 31, 2007
(in thousands)

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Revenues	$	$ 755,948	$ 84,979	$ (4,317)	$ 836,610
Cost and expenses	205	670,865	78,110	(4,309)	744,871
Operating income	(205)	85,083	6,869	(8)	91,739
Interest income	365	(4)	213		574
Interest and related expense	27,191	67	143		27,401
Other (income) expense, net	(25)	68	(371)		(328)
Management fees	871	(831)	(40)		
Royalties	688		(688)		
Intercompany interest	21,457	(21,334)	(123)		
Earnings (losses) before non-controlling interest and income taxes	(3,990)	62,779	6,459	(8)	65,240
Non-controlling interest			324		324
Earnings (losses) before income taxes	(3,990)	62,779	6,135	(8)	64,916
Income taxes	(1,384)	21,670	2,018	(8)	22,296
Earnings (losses) from subsidiary entities	45,226			(45,226)	
Net earnings	$ 42,620	$ 41,109	$ 4,117	$ (45,226)	$ 42,620

Condensed Consolidating Statements of Earnings
Three Months Ended December 31, 2006
(in thousands)

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Revenues	$	$ 624,840	$ 59,936	$ (4,415)	$ 680,361
Cost and expenses	18	551,798	56,335	(4,417)	603,734
Operating income (loss)	(18)	73,042	3,601	2	76,627
Interest income	300	21	49		370
Interest and related expenses	30,036	83	149		30,268
Other (income) expense, net	114	(87)	(98)		(71)
Management fees	701	(661)	(40)		
Royalties	526		(526)		
Intercompany interest	24,728	(24,651)	(77)		
	(3,913)	47,755	2,956	2	46,800

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Earnings (losses) before non-controlling interest and income taxes					
Non-controlling interest			131		131
Earnings (losses) before income taxes	(3,913)	47,755	2,825	2	46,669
Income taxes	(974)	11,974	573	2	11,575
Earnings (losses) from subsidiary entities	38,033			(38,033)	
Net earnings	$ 35,094	$ 35,781	$ 2,252	$ (38,033)	$ 35,094

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

17. Guarantor and Non-Guarantor Financial Statements (Continued)

Condensed Consolidating Statements of Earnings
Nine Months Ended December 31, 2007
(in thousands)

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Revenues	$	$ 2,143,008	$ 224,892	$ (11,891)	$ 2,356,009
Cost and expenses	577	1,946,637	205,471	(11,879)	2,140,806
Operating income (loss)	(577)	196,371	19,421	(12)	215,203
Interest income	1,126	39	348		1,513
Interest and related expense	83,563	222	432		84,217
Other (income) expense, net	(1,250)	252	957		(41)
Management fees	2,439	(2,321)	(118)		
Royalties	1,748		(1,748)		
Intercompany interest	67,567	(67,360)	(207)		
Earnings (losses) before non-controlling interest and income taxes	(10,010)	126,255	16,307	(12)	132,540
Non-controlling interest			1,403		1,403
Earnings (losses) before income taxes	(10,010)	126,255	14,904	(12)	131,137
Income taxes	(3,338)	42,380	4,802	(12)	43,832
Earnings (losses) from subsidiary entities	93,977			(93,977)	
Net earnings	$ 87,305	$ 83,875	$ 10,102	$ (93,977)	$ 87,305

Condensed Consolidating Statements of Earnings
Nine Months Ended December 31, 2006
(in thousands)

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Revenues	$	$ 1,853,484	$ 181,900	$ (13,220)	$ 2,022,164
Cost and expenses	(899)	1,654,184	168,611	(13,232)	1,808,664
Operating income	899	199,300	13,289	12	213,500
Interest income	691	69	108		868
Interest and related expenses	90,081	240	468		90,789
Other (income) expense, net	53	(125)	73		1
Management fees	2,151	(2,030)	(121)		
Royalties	1,666		(1,666)		
Intercompany interest	74,608	(74,341)	(267)		
Earnings (losses) before non-controlling interest and income taxes	(10,119)	122,883	10,802	12	123,578
Non-controlling interest			1,089		1,089

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Earnings (losses) before income taxes	(10,119)	122,883	9,713	12	122,489
Income taxes	(3,384)	41,038	3,240	12	40,906
Earnings (losses) from subsidiary entities	88,318			(88,318)	
Net earnings	$ 81,583	$ 81,845	$ 6,473	$ (88,318)	$ 81,583

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

17. Guarantor and Non-Guarantor Financial Statements (Continued)

Condensed Consolidating Statements of Cash Flows
Nine Months Ended December 31, 2007
(in thousands)

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net cash provided by operating activities	$ 88,001	$ 24,321	$ 6,199	$	$ 118,521
Cash flows from investing activities					
Capital expenditures	(5,768)	(37,512)	(5,510)		(48,790)
Payments pursuant to business combinations, net of cash acquired					
Dispositions of property, plant & equipment	65	341	4		410
Other, net					
Net cash used in investing activities	(5,703)	(37,171)	(5,506)		(48,380)
Cash flows from financing activities					
Borrowings on revolving line of credit	300,000				300,000
Repayments of revolving line of credit	(300,000)				(300,000)
Repayments of long-term debt	(127,063)	(154)	(1,881)		(129,098)
Excess tax benefit realized from share-based payment arrangements	4,274				4,274
Proceeds from stock option exercises	9,998				9,998
Dividends paid	(3,689)				(3,689)
Other			490		490
Net (repayments to) borrowings from parent company	(29,853)	13,004	14,595	2,254	
Net cash used in financing activities	(146,333)	12,850	13,204	2,254	(118,025)
Effect of exchange rates on cash and cash equivalents			236		236
Net (decrease) increase in cash and cash equivalents	(64,035)		14,133	2,254	(47,648)
Cash and cash equivalents, beginning of period	92,795		14,598	(11,560)	95,833
Cash and cash equivalents, end of period	$ 28,760	$	$ 28,731	$ (9,306)	$ 48,185

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

17. Guarantor and Non-Guarantor Financial Statements (Continued)

Condensed Consolidating Statements of Cash Flows
Nine Months Ended December 31, 2006
(in thousands)

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net cash provided by (used in) operating activities	$ 41,512	$ (708)	$ 20,850	$	$ 61,654
Cash flows from investing activities					
Capital expenditures	(4,423)	(30,675)	(3,015)		(38,113)
Payments pursuant to business combinations, net of cash acquired	(8,608)	(1,153)			(9,761)
Other, net	85	323			408
Net cash used in investing activities	(12,946)	(31,505)	(3,015)		(47,466)
Cash flows from financing activities					
Borrowings on revolving line of credit	385,500				385,500
Repayments of revolving line of credit	(355,500)				(355,500)
Borrowings of long-term debt			459		459
Repayments of long-term debt	(2,063)	(177)	(1,183)		(3,423)
Excess tax benefit realized from share-based payment arrangements	2,258				2,258
Proceeds from stock option exercises	8,517				8,517
Dividends paid	(3,619)				(3,619)
Other		245			245
Net (repayments to) borrowings from parent company	(49,447)	49,659	(212)		
Net cash provided by (used in) financing activities	(14,354)	49,727	(936)		34,437
Effects of exchange rates on cash and cash equivalents			(367)		(367)
Net increase in cash and cash equivalents	14,212	17,514	16,532		48,258
Cash and cash equivalents, beginning of period	15,905	(19,520)	4,908		1,293
Cash and cash equivalents, end of period	$ 30,117	$ (2,006)	$ 21,440	$	$ 49,551

18. Recently Issued Accounting Pronouncements

In September of 2006, the FASB issued SFAS No. 157, "Fair Value Measurement" (SFAS 157.) SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP) and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. However, for some entities, the application of this statement will change current practice. This

DRS TECHNOLOGIES, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

18. Recently Issued Accounting Pronouncements (Continued)

statement is effective beginning April 1, 2008 for DRS and is not expected to have a material impact on the Company's consolidated financial statements.

In December 2006, the FASB issued FASB Staff Position on Emerging Issues Task Force (EITF) No. 00-19-2, "Accounting for Registration Payment Arrangements" (FSP EITF 00-19-2). FSP EITF 00-19-2 provides that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement should be recognized separately and measured in accordance with SFAS No. 5, "Accounting for Contingencies," which provides that loss contingencies should be recognized as liabilities if they are probable and reasonably estimable. Subsequent to the adoption of FSP EITF 00-19-2, any changes in the carrying amount of the contingent liability will result in a gain or loss that will be recognized in the consolidated statement of earnings in the period the changes occur. The guidance in FSP EITF 00-19-2 became effective for the Company on April 1, 2007. The adoption of EITF 00-19-2 did not have a material impact on the Company's consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115" (SFAS 159). SFAS 159 permits entities to choose to measure eligible items at fair value at specified election dates and report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. SFAS 159 is effective for DRS beginning April 1, 2008. The Company is evaluating the impact of this statement on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations (SFAS 141R). SFAS 141R significantly changes the way companies account for business combinations and generally will require more assets acquired and liabilities assumed to be measured at their acquisition-date fair value. Under SFAS 141R, legal fees and other transaction-related costs are expensed as incurred and are no longer included in goodwill as a cost of acquiring the business. SFAS 141R also requires, among other things, acquirers to estimate the acquisition date fair value of any contingent consideration and to recognize any subsequent changes in the fair value of contingent consideration in earnings. In addition, restructuring costs the acquirer expected, but was not obligated to incur, will be recognized separately from the business acquisition. This statement is effective beginning April 1, 2009 for DRS.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements" an Amendment of ARB 51 (SFAS 160). SFAS 160 amends ARB 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. The statement requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. It also requires disclosure on the face of the consolidated statement of income of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. In addition, this statement establishes a single method of accounting for changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation and requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. This statement is effective beginning April 1, 2009 for DRS, and the Company currently is evaluating the impact of this statement on its consolidated financial statements.

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

We begin Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) of DRS Technologies, Inc. and its wholly-owned subsidiaries and controlling interests (hereinafter, we, us, our, the Company or DRS) with a company overview, followed by summaries of defense industry, strategy and other business considerations to provide context for understanding our business. This is followed by a discussion of the critical accounting estimates that we believe are important to understanding the assumptions and judgments incorporated in our reported financial results, which we discuss under "Results of Operations." We then provide an analysis of cash flows and discuss our financial commitments under "Liquidity and Capital Resources." This MD&A should be read in conjunction with the consolidated financial statements and related notes contained herein and in our March 31, 2007 Annual Report on Form 10-K.

Forward-Looking Statements

The following discussion and analysis contains forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that are based on management's beliefs and assumptions, current expectations, estimates and projections. Such statements, including statements relating to the Company's expectations for future financial performance, are not considered historical facts and are considered forward-looking statements under the federal securities laws. These statements may contain words such as "believes," "anticipates," "plans," "expects," "intends," "estimates" or similar expressions. These statements are not guarantees of our future performance and are subject to risks, uncertainties and other important factors that could cause our actual performance or achievements to differ materially from those expressed or implied by these forward-looking statements and include, without limitation: the effect of our acquisition strategy on future operating results, including our ability to effectively integrate acquired companies into our existing operations; the uncertainty of acceptance of new products and successful bidding for new contracts; the effect of technological changes or obsolescence relating to our products and services; and the effects of government regulation or shifts in government policy, as they may relate to our products and services, and other risks or uncertainties detailed in Item 1A, "Risk Factors," included in our March 31, 2007 Annual Report on Form 10-K. Given these uncertainties, you should not rely on forward-looking statements. The Company undertakes no obligations to update any forward-looking statements, whether as a result of new information, future events or otherwise.

Company Overview

DRS is a supplier of defense electronic products, systems and military support services. We provide high-technology products, services and support to all branches of the U.S. military, major aerospace and defense prime contractors, government intelligence agencies, certain international military forces and industrial markets.

The Company has four principal operating segments, on the basis of products and services offered: the Command, Control, Communications, Computers and Intelligence (C4I) Segment, the Reconnaissance, Surveillance & Target Acquisition (RSTA) Segment, the Sustainment Systems Segment and the Technical Services Segment. All other operations, primarily our Corporate Headquarters, are grouped in Other.

On October 1, 2007 the ESSIBuy operating unit, an operating unit of the Technical Services Segment, was consolidated into an operating unit of the Sustainment Systems Segment to achieve certain operating synergies. The balance sheet and operating results of ESSIBuy were reclassified for the period from April 1, 2007 through September 30, 2007. The results in the prior-year were not reclassified as they were considered immaterial to both segments.

The C4I Segment is comprised of the following business areas: Command, Control & Communications (C3), which includes naval display systems, ship communications systems, radar

systems, technical support, electronic manufacturing and system integration services, secure voice and data communications, air combat training, electronic warfare and ship network systems; Power Systems, which includes naval and industrial power generation, conversion, propulsion, distribution and control systems; Intelligence Technologies, which includes signals intelligence, communications intelligence, data collection, processing and dissemination equipment, high-speed digital data and imaging systems, unmanned vehicles, and mission and flight recorders; Tactical Systems, which includes battle management tactical computer systems, peripherals, electronic test and diagnostics, and vehicle electronics; and Homeland Security, which includes integration of traditional security infrastructures into a single, comprehensive border security suite for the Department of Homeland Security.

The RSTA Segment develops and produces electro-optical sighting, targeting and weapon sensor systems, image intensification (I^2) night vision, combat identification and laser aimer/illuminator products, and provides electronic manufacturing services.

The Sustainment Systems Segment designs, engineers and manufactures integrated military electronics and other military support equipment, primarily for the U.S. Department of Defense (DoD), as well as related heat transfer and air handling equipment, and power generation and distribution equipment for domestic commercial and industrial users.

The Technical Services Segment provides engineering services, logistics and training services, advanced technology services, asset protection systems and services, telecommunication systems integration and information technology services, power generation and vehicle armor kits for military, intelligence, humanitarian, disaster recovery and emergency responder applications.

Defense Industry Considerations and Business Strategy

The substantial majority of our revenue is generated pursuant to written contractual arrangements to design, develop, manufacture and/or modify complex products and to provide related engineering, technical and other services according to the specifications of the buyers (customers). Our primary "end-use" customer is the DoD. Our other customers include certain U.S. government intelligence agencies, foreign governments, commercial customers and other U.S. federal, state and local government agencies.

The Global War on Terrorism (GWOT), Operation Enduring Freedom in Afghanistan and Operation Iraqi Freedom have altered the global defense and security environment and have had, and for the foreseeable future are likely to continue to have, a significant impact on the markets for defense and advanced technology systems and products. The DoD continues to focus on both supporting ongoing operations in Afghanistan and Iraq and transforming the U.S. military to confront future threats. In addition, the Office of Homeland Security and other U.S. government agencies continue to focus on enhancing the security of the United States. While the future direction of current operations remains unsettled, we believe that the 2006 Quadrennial Defense Review, a comprehensive report issued by the DoD every four years on defense strategy, force structure, force modernization plans, infrastructure, budget plans, and other elements of U.S. defense programs and policies (the QDR), will continue to drive strategic thinking and budget priorities in the near term. The QDR recommended certain changes to force structure, particularly with respect to special operations forces, relating to the GWOT and the insurgency in Iraq. However, at the same time, the QDR also largely maintained the DoD's transformation initiatives. The President's fiscal year 2008 and 2009 budget and Future Years Defense Plan (FYDP), which projects defense costs for the next five years, are consistent with the 2006 QDR's recommendations.

Over the past several years, DoD budgets have experienced increased focus on command, control, communications, computers, intelligence, surveillance and reconnaissance (C4ISR), precision-guided weapons, unmanned aerial vehicles (UAVs), network-centric communications, Special Operations Forces (SOF) and missile defense. In addition, we believe the DoD philosophy has focused on a transformation strategy that balances modernization and recapitalization (or upgrading existing

platforms), while enhancing readiness and joint operations. As a result, we believe defense budget program allocations continue to favor advanced information technologies related to C4ISR. Furthermore, the DoD's emphasis on system interoperability, force multipliers and the provision to battlefield commanders of real-time data is increasing the electronic content of nearly all major military procurement and research programs.

Our strategy is designed to capitalize on the breadth of our technology and extensive expertise in order to meet the evolving needs of our customers. We intend to expand our share of existing programs and participate in new programs by leveraging the strong relationships that we have developed with the DoD, several other U.S. government agencies and all of the major U.S. defense prime contractors. We plan to continue to align our research and development, manufacturing and new business efforts to complement our customers' requirements and to provide state-of-the-art products and services. We plan to maintain a diversified and broad business mix with limited reliance on any single program, significant follow-on business and an attractive customer profile. We also intend to expand our technical services and support offerings to the DoD, thus further diversifying our business beyond the historical investment accounts and into Operations and Maintenance (O&M) funded activities.

A significant component of our strategy has been to enhance our existing product base through selective acquisitions that add new products, services and technologies in areas that complement our present business base. We intend to continue acquiring select publicly and privately held companies, as well as defense businesses of larger companies that (i) exhibit significant market position(s) in their business areas, (ii) offer products that complement and/or expand our product offerings and (iii) display growing revenues and positive operating income and cash flow prospects.

Other Business Considerations

As a government contractor, we are subject to U.S. government oversight. The government may ask about and investigate our business practices and audit our compliance with applicable rules and regulations. Depending on the results of those audits and investigations, the government could make claims against us. Under government procurement regulations and practices, an indictment of a government contractor could result in that contractor being fined and/or suspended from being able to bid on, or be awarded, new government contracts for a period of time. A conviction could result in debarment for a specific period of time. Similar government oversight exists in most other countries where we conduct business.

We are party to various legal actions and claims arising in the ordinary course of our business. We believe we have adequate legal defenses for each of the actions and claims, and we believe that their ultimate disposition will not have a material adverse effect on our consolidated financial position, results of operations or liquidity. It is possible, however, that the ultimate resolution of those matters could result in a material adverse effect on our results of operations and/or cash flows from operating activities for a particular reporting period. (see Part II. Other Information, Item 1. Legal Proceedings).

We assume greater financial risk on fixed-price contracts than on cost-type contracts. Failure to anticipate technical problems, estimate costs accurately or control costs during performance of a fixed-price contract will reduce our profit or cause a loss. In particular, because of their inherent uncertainties and consequent cost overruns, development and development with follow-on production-type contracts historically have been less profitable than pure production contracts. Although we believe that adequate provision for our costs of performance is reflected in our consolidated financial statements, we can give no assurance that losses on fixed-price and cost-type contracts will not occur in the future. We also cannot assure you that current cost-type contracts will not be changed to fixed-price contracts.

Our sales to international customers involve additional risks, such as exposure to currency fluctuations and changes in foreign economic and political environments. International transactions frequently involve increased financial and legal risks arising from stringent contractual terms and

conditions, and widely differing legal systems, licensing requirements, customs and practices in foreign countries. We expect that international sales, as a percentage of our overall sales, may increase in future years as a result of, among other factors, our growth strategy and continuing changes in the defense industry.

Our future operating results depend on our ability to successfully compete in a highly competitive industry that is characterized by rapid technological change. We have historically participated successfully in the defense industry consolidation through strategic business acquisitions and by streamlining our existing operations; however, we cannot guarantee that we will have sufficient funds available to us to continue investing in business acquisitions. Even if new financing were made available to us, it may not be on terms acceptable to us.

Critical Accounting Policies

Our consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America. Preparing consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosures of contingent assets and liabilities. These estimates and assumptions are affected by the application of our accounting policies. Our significant accounting policies are described in Note 1 to the Consolidated Financial Statements included in our March 31, 2007 Annual Report on Form 10-K. Except as described below, there were no significant changes in the Company's critical accounting policies during the nine months ended December 31, 2007. Critical accounting policies are those that require application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain and may change in subsequent periods. Critical accounting policies for us include revenue recognition on contracts and contract estimates, valuation of goodwill and acquired intangible assets, pension plan and postretirement benefit plan obligations, accounting for income taxes, share-based payments and other management estimates.

We adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48 (FIN 48) effective April 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes," and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. We had no cumulative effect adjustment related to the adoption. However, certain amounts have been reclassified in the consolidated balance sheet in order to comply with the requirements of the statement.

Results of Operations

Our operating cycle is long term and involves various types of production contracts and varying production delivery schedules. Accordingly, operating results of a particular year, or year-to-year comparisons of recorded revenues and earnings, may not be indicative of future operating results. Members of our senior management team regularly review key performance metrics and the status of operating initiatives within our business. These key performance indicators are primarily revenues, operating income and bookings. We review this information on a monthly basis through operating segment reviews, which include, among other operating issues, discussions related to significant programs, proposed investments in new business opportunities or property, plant and equipment, and integration and cost reduction efforts. The following table presents a summary comparison of the key

performance metrics, other significant financial metrics and significant liquidity metrics monitored by our senior management.

	Three Months Ended December 31,			Nine Months Ended December 31,		
	2007	2006	Percent Change	2007	2006	Percent Change
	(in thousands, except percentages)					
Key performance metrics						
Revenues	$ 836,610	$ 680,361	23.0%	$ 2,356,009	$ 2,022,164	16.5%
Operating income	$ 91,740	$ 76,627	19.7%	$ 215,203	$ 213,500	0.8%
Bookings	$ 857,866	$ 1,102,874	(22.2)%	$ 2,905,413	$ 2,800,243	3.8%
Other significant financial metrics						
Interest and related expenses	$ 27,401	$ 30,268	(9.5)%	$ 84,217	$ 90,789	(7.2)%
Income taxes	$ 22,296	$ 11,575	92.6%	$ 43,832	$ 40,906	7.2%
Significant liquidity metrics(A)						
Free cash flow	$ 41,487	$ 18,430	125.1%	$ 69,731	$ 23,541	196.2%
EBITDA	$ 111,647	$ 95,326	17.1%	$ 271,104	$ 269,532	0.6%

(A)
See "Liquidity and Capital Resources" and "Use of Non-GAAP Financial Measures" for additional discussion and information.

Three-Month and Nine-Month Periods Ended December 31, 2007, Compared with the Three- and Nine-Month Periods Ended December 31, 2006

Revenues and operating income Consolidated revenues and operating income for the three-month period ended December 31, 2007 increased $156.2 million and $15.1 million, respectively, to $836.6 million and $91.7 million, respectively, as compared with the corresponding period in the prior-year. The primary drivers of the increase in revenues over the prior-year period were increased shipments of driver vision enhancement equipment and components for ground-based vehicles and increased demand for and services provided under the R2 program. Also driving revenues higher were increased shipments of thermal imaging systems and subsystems for long-range surveillance systems, thermal weapons sights and combat display workstations. Partially offsetting the overall increase in revenues were lower demand for certain ship-based surface search radar systems, night vision systems and lower shipments of certain rugged computers sold in the international market due to program completion.

The growth in operating income in the third quarter of fiscal 2008, as compared with the third quarter in the prior-year, was largely due to the overall increase in revenues, strong margins at our Tactical Systems strategic business unit and lower costs for certain employee benefits due to an adjustment to reflect better than anticipated claims experience. Partially offsetting the overall operating income increase were lower margins at our Sustainment Systems segment compared with the prior-year. See *Operating Segments* discussion below for additional information.

Consolidated revenues and operating income for the nine-month period ended December 31, 2007 increased $333.8 million and $1.7 million, respectively, to $2.36 billion and $215.2 million, respectively, as compared with the corresponding period in the prior-year. The primary drivers of the increase in revenues over the prior-year period were increased shipments of driver vision enhancement equipment and components for ground-based vehicles and higher demand for equipment and services provided under the R2 program. Also contributing to the increase in revenues were greater shipments of rugged computer systems, ground-based target acquisition and missile control subsystems, and thermal imaging systems and subsystems for long-range surveillance systems. Partially offsetting higher overall revenues were lower demand for certain rugged computers sold in the international market due to program

completion, decreased engineering and development volume for certain power conversion equipment and lower demand for add-on commercial vehicle armor kits.

The increase in operating income for the nine-month period ended December 31, 2007, as compared with the corresponding prior-year period was largely due to higher overall revenues, strong margins at our Tactical Systems strategic business unit and an $11.7 million curtailment gain recorded in the Sustainment Systems Segment. The increase in operating income was largely offset by a $36.8 million charge on the TWS II program. The operating charge primarily reflected the cost of procuring new material following design modifications, coupled with the write-off of existing inventory that can no longer be utilized on the program. During the nine months ended December 31, 2006, we recorded $3.7 million of severance-related costs in advance of the new organizational operating structure implemented in the third quarter of fiscal 2007. See *Operating Segments* discussion below for additional information.

Bookings We generally define bookings as the value of contract awards received from the U.S. government, for which the U.S. government has appropriated funds, plus the value of contract awards and orders received from customers other than the U.S. government. Bookings for the three-month period ended December 31, 2007 decreased $245.0 million, as compared with the same period in the prior-year, to $857.9 million. The primary drivers of the decrease were lower bookings for TWS II and thermal imaging systems and subsystems for long-range surveillance systems from our RSTA Segment.

Bookings for the nine-month period ended December 31, 2007 increased $105.2 million, as compared with the same period in the prior-year, to $2.91 billion. The primary drivers of the increase were strong demand for driver vision enhancement equipment and components for ground-based vehicles from our C4I and RSTA segments, rugged computer systems and certain sonar systems from our C4I segment, and airborne electro-optical sighting systems and ground-based target acquisition and missile control subsystems from our RSTA segment. Partially offsetting the higher overall bookings were lower bookings for TWS II and thermal imaging systems and subsystems for long-range surveillance systems from our RSTA Segment.

Interest and related expenses Interest and related expenses decreased $2.9 million and $6.6 million for the three- and nine-month periods ended December 31, 2007, as compared with the same periods in the prior-year, to $27.4 million and $84.2 million, respectively. Lower interest and related expenses were primarily the result of a decrease in our average borrowings outstanding for the three-and nine-month periods ended December 31, 2007, as compared with the corresponding periods in the prior-year. We had no borrowings outstanding under our revolving credit facility at December 31, 2007 and at December 31, 2006 had approximately $70.0 million outstanding. In addition, we prepaid, at our discretion, approximately $125.0 million of our outstanding term loan during fiscal 2008. With the adoption of FIN 48 on April 1, 2007, we began recording the interest associated with our income tax contingencies as a component of interest expense. For the nine-month period ended December 31, 2007, we recorded $0.2 million of interest expense associated with income tax contingencies, which is net of a $0.1 million reduction to interest expense related to income tax contingencies, accrued, reversed or settled during the three months ended December 31, 2007.

Income taxes The provision for income taxes for the three- and nine-month periods ended December 31, 2007 reflected an effective income tax rate of approximately 34.3% and 33.4%, respectively, as compared with 24.8% and 33.4%, respectively, in the same periods in the prior-year. Our effective tax rate for the third quarter includes $1.0 million of discrete tax benefits compared to $5.5 million in the comparable quarter from the prior-year. The discrete cumulative benefit in the third quarter of the prior year, is related to an Extraterritorial Income Exclusion benefit. We anticipate that our effective income tax rate for the year ended March 31, 2008 will approximate 34.5%.

Operating Segments

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

	Three Months Ended December 31,		Three Months Ended Percent Changes	Nine Months Ended December 31,		Nine Months Ended Percent Changes
	2007	2006	2007 vs. 2006	2007	2006	2007 vs. 2006
	(in thousands, except for percentages)					
C4I Segment						
Revenues	$ 333,413	$ 268,053	24.4%	$ 941,231	$ 811,744	16.0%
Operating income	$ 39,019	$ 27,669	41.0%	$ 105,007	$ 88,072	19.2%
Operating margin	11.7%	10.3%	13.6%	11.2%	10.8%	3.7%
RSTA Segment						
Revenues	$ 206,694	$ 166,786	23.9%	$ 549,048	$ 430,150	27.6%
Operating income	$ 25,143	$ 20,588	22.1%	$ 22,432	$ 46,412	(51.7)%
Operating margin	12.2%	12.3%	(0.8)%	4.1%	10.8%	(62.0)%
Sustainment Systems Segment						
Revenues	$ 129,629	$ 95,994	35.0%	$ 354,019	$ 280,327	26.3%
Operating income	$ 15,154	$ 17,039	(11.1)%	$ 51,108	$ 41,654	22.7%
Operating margin	11.7%	17.8%	(34.3)%	14.4%	14.9%	(3.4)%
Technical Services Segment						
Revenues	$ 166,874	$ 149,528	11.6%	$ 511,711	$ 499,943	2.4%
Operating income	$ 12,652	$ 11,390	11.1%	$ 37,292	$ 36,578	2.0%
Operating margin	7.6%	7.6%	0.0%	7.3%	7.3%	0.0%
Other						
Operating (loss) income	$ (228)	$ (59)	(286.4)%	$ (636)	$ 784	(181.1)%

Three-Month Period Ended December 31, 2007, Compared with the Three-Month Period Ended December 31, 2006

C4I Segment Revenues increased $65.4 million, or 24.4%, to $333.4 million for the three-month period ended December 31, 2007, as compared with the corresponding prior-year period. Operating income increased $11.4 million, or 41.0%, to $39.0 million. The increase in revenue primarily was attributable to increased shipments of components for driver vision enhancement equipment for ground-based vehicles, combat display workstations, replacement video display modules, chassis modernization kits, certain underwater sonar systems and higher engineering and development revenues from a naval infrared search and track program. Partially offsetting higher overall revenues were lower shipments of ship-based surface search radar systems and certain rugged computer systems sold in international markets due to program completion.

The increase in operating income for the three-month period ended December 31, 2007, as compared with the corresponding period in the prior year, was largely due to higher overall revenues. Contributing to improved margins was a video display program that ramped up unit deliveries early in the fiscal year and completed deliveries during the third quarter of fiscal 2008, as well as a rugged computer program that is nearing completion of deliveries under existing delivery order pricing. Certain fiscal 2009 shipments of these rugged computers will be under new delivery order pricing that, in the near term, is not expected to be as favorable.

RSTA Segment Revenues increased $39.9 million, or 23.9%, to $206.7 million for the three month period ended December 31, 2007, as compared with the corresponding prior-year period.

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Operating income increased $4.6 million, or 22.1%, to $25.1 million. The increase in revenues was primarily attributable to higher shipments of thermal imaging systems and subsystems for a long-range surveillance system, driver vision enhancement equipment for ground-based vehicles and increased revenues from the TWS II program. Partially offsetting the overall increase in revenues was decreased demand for certain night vision systems and infrared sighting and targeting systems for ground-based vehicles.

The increase in operating income for the three-month period ended December 31, 2007, as compared with the corresponding period in the prior year, was largely due to higher overall revenues and favorable margins for certain thermal imaging systems and subsystems.

Sustainment Systems Segment Revenues increased $33.6 million, or 35.0%, to $129.6 million for the three-month period ended December 31, 2007, as compared with the corresponding prior-year period. Operating income decreased $1.9 million, or 11.1%, to $15.2 million. The primary drivers of the increase in revenue during the period were increased shipments of tactical quiet generators, and greater demand for replacement environmental control systems for missile launch and alert facilities and heavy mobile ammunition trailers for the U.S. Army. Partially offsetting higher overall revenues was lower demand for precision targeting systems.

Operating income declined over the prior-year period, as higher overall revenues were more than offset by cost growth on certain mobile environmental systems programs.

Technical Services Segment Revenues increased $17.3 million, or 11.6%, to $166.9 million for the three-month period ended December 31, 2007, as compared with the corresponding prior-year period. Operating income increased $1.3 million, or 11.1%, to $12.7 million. Revenues increased primarily due to higher demand for equipment and services provided under the R2 program and greater volume from commercial vehicle armor kits. Partially offsetting the overall increase in revenues was lower demand for the defense communication transmission system program and a commercial intrusion detection program.

The increase in operating income was largely due to higher overall revenues on the R2 program.

Other The operating loss in Other consists of certain non-allocable general and administrative expenses at DRS corporate.

Nine-Month Period Ended December 31, 2007, Compared with the Nine-Month Period Ended December 31, 2006

C4I Segment Revenues increased $129.5 million, or 16.0%, to $941.2 million for the nine-month period ended December 31, 2007, as compared with the corresponding prior-year period. Operating income increased $16.9 million, or 19.2%, to $105.0 million. The increase in revenue was principally attributable to increased shipments of components for driver vision enhancement systems for ground-based vehicles, certain rugged computer systems, replacement video display modules, combat display workstations and certain underwater sonar systems. Partially offsetting overall higher revenues were lower shipments of rugged computer systems sold in the international market and a decrease in engineering and development for certain power conversion equipment.

The increase in operating income for the nine-month period ended December 31, 2007, as compared with the corresponding period in the prior year, was largely due to higher overall revenue, offset in part by lower margins at C4I's Intelligence Technologies and Command, Control & Communications business units. Contributing to improved margins was a video display program that ramped up unit deliveries early in the fiscal year and completed deliveries during the third quarter of fiscal 2008, as well as a rugged computer program that is nearing completion of deliveries under existing delivery order pricing. Certain fiscal 2009 shipments of these rugged computers will be under new delivery order pricing that, in the near term, is not expected to be as favorable.

RSTA Segment Revenues increased $118.9 million, or 27.6%, to $549.0 million for the nine-month period ended December 31, 2007, as compared with the corresponding prior-year period. Operating income decreased $24.0 million, or 51.7%, to $22.4 million. The increase in revenues was primarily attributable to greater shipments of driver vision enhancement equipment for ground-based vehicles, ground-based target acquisition and missile control subsystems, thermal imaging systems and subsystems for a long-range surveillance system, and a certain airborne and ship-based infrared target acquisition program. Partially offsetting the overall increase in revenues was lower volume from night vision systems.

The decrease in operating income and operating margin for the nine-month period ended December 31, 2007, as compared with the corresponding period in the prior year, was largely due to a charge of $36.8 million on the TWS II program. Partially offsetting the lower operating income were higher overall revenues and favorable margins for certain thermal imaging systems and subsystems. During the nine-month period ended December 31, 2006, we recorded $2.0 million of severance-related costs in advance of the organizational operating structure implemented in the third quarter of fiscal 2007.

The TWS II charge reflected the cost of procuring new material following design modifications, as well as the write-off of certain obsolete inventory. As a result of the design changes, we also transferred $30.0 million of saleable inventory and components from the TWS II program (transferred inventory) to inventory, which is valued at the lower of cost or market as of December 31, 2007. We believe that the transferred inventory will be sold primarily through international distribution channels. The sale of certain products outside of the United States is highly regulated, and any inability to obtain the requisite licenses or comply with applicable government export regulations may affect our ability to export the transferred inventory. If we are precluded from the sale of the transferred inventory to certain international customers, and/or are unable to generate sufficient domestic revenues, the value of the transferred inventory may be required to be written down or written off in a future period. Such a write-down or write-off could be material to the results of operations in any one period. During the third quarter of fiscal 2008, we received an order for $5.3 million of thermal weapon sights that we expect will be shipped out of transferred inventory during the fourth quarter of fiscal 2008. As of December 31, 2007 approximately $21.5 million of transferred inventory and components remained with us.

Sustainment Systems Segment Revenues increased $73.7 million, or 26.3%, to $354.0 million for the nine-month period ended December 31, 2007, as compared with the corresponding prior-year period. Operating income increased $9.5 million, or 22.7%, to $51.1 million. The primary drivers of the increase in revenues were increased shipments of tactical quiet generator sets, higher demand for replacement environmental control systems for missile launch and alert facilities, heavy mobile ammunition trailers for the U.S. Army and transportable consolidated automatic support system equipment for the U.S. Navy. Partially offsetting overall higher revenues were lower demand for a precision targeting system.

The increase in operating income over the corresponding period in the prior year was due to an $11.7 million curtailment gain recorded for one of our retirement plans. Higher overall revenues were offset by cost growth from certain mobile environmental systems programs. During the nine-month period ended December 31, 2006, we recorded $1.2 million of severance-related costs in advance of the new organizational operating structure implemented in the third quarter of fiscal 2007.

Technical Services Segment Revenues increased $11.8 million, or 2.4%, to $511.7 million for the nine-month period ended December 31, 2007, as compared with the corresponding prior-year period. Operating income increased $0.7 million, or 2.0%, to $37.3 million. The primary revenue drivers in the segment were demand for equipment and services provided under the R2 program, largely offset by lower volume from commercial vehicle armor kits and lower demand for the defense communication transmission system program and mobile power generation and distribution equipment for the US Air Force.

The increase in operating income was largely due to the favorable margins on our R2 program as compared to the prior year. During the nine-month period ended December 31, 2006, we recorded $0.5 million of severance-related costs in advance of the new organizational operating structure implemented in the third quarter of fiscal 2007.

Other The operating loss in Other consists of certain non-allocable general and administrative expenses at DRS corporate. During the nine-month period ended December 31, 2006, we realized a $1.3 million gain on the collection of a note receivable that previously had been partially reserved.

Liquidity and Capital Resources

	Nine Months Ended December 31,	
	2007	2006
	(in thousands)	
Net cash provided by operating activities	$ 118,521	$ 61,654
Net cash used in investing activities	$ (48,380)	$ (47,466)
Net cash (used in) provided by financing activities	$ (118,025)	$ 34,437

Operating activities During the nine months ended December 31, 2007, we generated $118.5 million of operating cash flow, $56.8 million more than the $61.7 million of operating cash flow generated in the same period in the prior year. Net earnings increased $5.7 million to $87.3 million. Non-cash adjustments to reconcile net earnings to cash flows from operating activities increased $31.0 million over the corresponding period in the prior year, driven primarily by a $36.8 million non-cash write-off of inventory related to the TWS II program, offset in part by a non-cash pension curtailment gain of $11.7 million.

Changes in assets and liabilities, net of effects from business combinations, used $73.3 million in cash for the nine months ended December 31, 2007. Inventories used $87.6 million of cash during the period primarily driven by the TWS II program, as we continued to procure new material following recent design modifications. The remaining increase in inventory consisted of costs incurred on driver vision enhancement equipment for ground-based vehicles incurred to satisfy fourth quarter customer demand and mobilized environmental programs resulting from delayed product shipments. Accounts payable used $12.0 million of cash during the period. Customer advances provided $45.4 million of cash during the period, primarily as a result of payments received on ground-based target acquisition and missile control subsystems, vision enhancement equipment for ground-based vehicles, and thermal imaging systems and subsystems for a long-range surveillance system. Accounts receivable provided $4.2 million of cash, as net collections exceeded billings. Accrued expenses and other current liabilities used $12.9 million of cash, mainly due to the liquidation of certain contract-related reserves, offset by an increase in warranty accruals for an infrared sighting and targeting system, driver vision enhancement equipment and Apache helicopter programs.

Investing activities We paid $48.8 million for capital improvements during the nine months ended December 31, 2007, as compared with $38.1 million in the corresponding prior-year period. We expect our capital expenditures to be in the range of $75.0 million to $85.0 million in fiscal 2008, as we continue to upgrade our facilities and information technology infrastructure.

Financing activities For the nine months ended December 31, 2007, financing activities used $118.0 million in cash. We prepaid $125.0 million of our term loan and made $4.1 million in scheduled repayments under various long-term debt arrangements during the first nine months of fiscal 2008. We also received $14.3 million from the exercise of stock options and related excess tax benefits, and paid $3.7 million in cash dividends.

Simultaneously with the closing of our acquisition of Engineered Support Systems, Inc. (ESSI), on January 31, 2006 we entered into an amended and restated credit facility for up to an aggregate amount of $675.0 million with a syndicate of lenders (the Credit Facility), replacing our previously existing credit facility. The Credit Facility consists of a $400.0 million senior secured revolving line of credit and a $275.0 million senior secured term loan. We are permitted, on no more than two occasions, to increase the aggregate amount of the Credit Facility by up to $250.0 million, subject to certain restrictions. Any increase in the aggregate amount of the Credit Facility may be borrowed in the form of either additional term loans or available amounts under the revolving line of credit. The Credit Facility is guaranteed by substantially all of DRS's domestic subsidiaries. In addition, it is collateralized by liens on substantially all of the assets of our subsidiary guarantors, certain of DRS's other subsidiaries' assets and by a pledge of a portion of certain of our non-guarantor subsidiaries' capital stock.

From time to time, the Company enters into standby letters-of-credit and bank guarantee agreements with financial institutions and customers, primarily relating to the guarantee of its future performance on certain contracts to provide products and services and to secure advance payments it has received from its customers. As of December 31, 2007, $32.7 million was contingently payable under letters of credit and bank guarantees. Of this amount, approximately $0.9 million and $0.3 million in letters of credit and bank guarantees, respectively, were issued under a previous credit agreement and by a bank agreement for the Company's U.K. subsidiary, respectively, and are not considered when determining the availability under the Company's revolving line of credit. At December 31, 2007, the Company had $368.5 million of availability under its revolving line of credit.

On March 29, 2006, DRS Technologies Canada Company (DRS Canada) established a five-year senior secured term loan (Canadian Term Loan) for approximately $9.9 million (C$11.5 million), maturing on April 1, 2011. The proceeds of the loan were utilized to permit repatriation of certain amounts from Canada to the U.S., which were subject to more favorable tax treatment under the Jobs Act. The debt is collateralized by the assets of DRS Canada and guaranteed by DRS Technologies, Inc. We are subject to the same financial covenants under the DRS Canada loan as we are under the Credit Facility, and DRS Canada is subject to other non-financial covenants that are similar to those described for the Credit Facility. The carrying value of the Canadian Term Loan increased $1.3 million during the nine months ended December 31, 2007, as a result of the strengthening of the Canadian dollar compared to the U.S. dollar during that period.

On October 30, 2003, we issued $350.0 million aggregate principal amount of $6^7/_8$% senior subordinated notes, due November 1, 2013 (the October 2003 Notes). The net proceeds of the October 2003 Notes, together with a portion of our available cash and initial borrowings under the then existing credit facility, were used to fund the acquisition of Integrated Defense Technologies, Inc. (IDT), repay certain of DRS's and IDT's outstanding indebtedness, and pay related fees and expenses. The October 2003 Notes were issued under an indenture with The Bank of New York. Subject to a number of exceptions, the indenture restricts our ability and the ability of our subsidiaries to incur more debt, pay dividends and make distributions, make certain investments, repurchase stock, create liens, enter into transactions with affiliates, enter into sale lease-back transactions, merge or consolidate, and transfer or sell assets. The October 2003 Notes are unconditionally guaranteed, jointly and severally, by DRS's current and future wholly-owned domestic subsidiaries. The foreign subsidiaries and certain domestic subsidiaries of DRS do not guarantee the October 2003 Notes.

On December 23, 2004, we issued an additional $200.0 million aggregate principal amount of $6^7/_8$% senior subordinated notes, due November 2013 (the December 2004 Notes). The December 2004 Notes were offered as additional debt securities under our indenture with the Bank of New York with identical terms and the same guarantors as the October 2003 Notes.

On January 31, 2006, in connection with the acquisition of ESSI, we issued $900.0 million of new debt securities, including $350.0 million aggregate principal amount of 6 5/8% senior notes due 2016, $250.0 million aggregate principal amount of 7 5/8% senior subordinated notes due 2018 (collectively called the January 2006 Notes) and $300.0 million aggregate principal amount of 2.0% convertible senior notes due 2026 (Convertible Notes). On February 8, 2006, we sold an additional $45.0 million of Convertible Notes pursuant to an overallotment option exercised by the initial purchasers of the Convertible Notes. The net proceeds of the January 2006 Notes and the Convertible Notes, together with a portion of our available cash and initial borrowings under the Credit Facility, were used to fund the ESSI acquisition, repay certain of ESSI's outstanding indebtedness, and pay related fees and expenses.

In January 2006, in connection with the offering of our 2% Convertible Senior Notes due 2026 (Convertible Notes), we entered into a registration rights agreement relating to our Common Stock issuable upon conversion of the Convertible Notes. Pursuant to the registration rights agreement, if we do not file a prospectus supplement or shelf registration statement relating to the resale of the Common Stock within certain specified time periods or maintain the effectiveness of a registration statement related to the resale of the Common Stock, subject to certain exceptions, we could be subject to additional interest. We believe the likelihood of occurrence of such event is remote and, as such, we have not recorded a liability at December 31, 2007. In the event that it becomes probable that we would have to pay additional interest under the registration rights agreement, we estimate the maximum potential amount as of December 31, 2007 would be approximately $3.5 million per year.

The January 2006 Notes are unsecured. The 7 5/8% senior subordinated notes rank behind the Credit Facility, the 6 5/8% senior notes, the Convertible Notes and trade payables, and are *pari passu* with the 6 7/8% senior subordinated notes. The January 2006 Notes were issued under indentures with The Bank of New York. Subject to a number of exceptions, the indentures restrict our ability and the ability of our subsidiaries to incur more debt, pay dividends and make distributions, make certain investments, repurchase stock, create liens, enter into transactions with affiliates, enter into sale lease-back transactions, merge or consolidate, and transfer or sell assets. The January 2006 Notes are unconditionally guaranteed, jointly and severally, by certain of our existing and future domestic subsidiaries.

Certain of our debt arrangements contain customary representations, warranties and default provisions, as well as restrictions that, among other things, limit the amount of debt that we may have outstanding. As of December 31, 2007, we were in compliance with all such financial covenants.

Accrued interest expense at December 31, 2007 and March 31, 2007 was approximately $27.8 million and $25.6 million, respectively.

Based upon our anticipated level of future operations, we believe that our existing cash and cash equivalents balances and our cash generated from operating activities, together with available borrowings under our amended and restated senior secured credit facility, will be adequate to meet our anticipated requirements for working capital, capital expenditures, commitments, research and development expenditures, contingent purchase prices, program and other discretionary investments, and interest and principal payments for the foreseeable future. There can be no assurance, however, that our business will continue to generate cash flow at current levels. If we are unable to generate sufficient cash flow from operations to service our debt, we may be required to sell assets, reduce capital expenditures, refinance all or a portion of our existing debt or obtain additional financing. Our ability to make scheduled principal payments or to pay interest on or to refinance our indebtedness depends on our future performance and financial results, which, to a certain extent, are subject to general conditions in or affecting the defense industry and to general economic, political, financial, competitive, legislative and regulatory factors beyond our control. There can be no assurance that

sufficient funds will be available to enable us to service our indebtedness, make necessary capital expenditures or to make discretionary investments.

Dividends On November 8, 2007, the Board of Directors declared a $0.03 per common share cash dividend, payable on December 31, 2007 to stockholders of record as of December 14, 2007. On February 7, 2008, the Board of Directors declared a $0.03 per common share cash dividend, payable on March 31, 2008 to stockholders of record as of March 14, 2008.

Free cash flow Free cash flow represents net cash provided by operating activities less capital expenditures. Free cash flow for the three-month period ended December 31, 2007 was $41.5 million, or $23.1 million more than $18.4 million in the corresponding period in the prior year. Free cash flow for the nine-month period ended December 31, 2007 was $69.7 million, or $46.2 million more than $23.5 million in the corresponding period in the prior year. See "Use of Non-GAAP Financial Measures" below for additional discussion and information.

EBITDA Net earnings before net interest and related expenses (primarily the amortization and write-off of debt premium and issuance costs), income taxes, depreciation and amortization (EBITDA) for the three-month period ended December 31, 2007 was $111.6 million, or $16.3 million more than the $95.3 million in the corresponding period in the prior year. EBITDA for the nine-month period ended December 31, 2007 was $271.1 million, or $1.6 million more than the $269.5 million in the corresponding period in the prior year. See "Use of Non-GAAP Financial Measures" below for additional discussion and information.

Off-Balance Sheet Financing Arrangements We have $345 million of 2% senior convertible notes with a conversion price of $59.70 per share. Upon conversion, we would satisfy our obligation to convert the notes by delivering to the holders cash for the principal amount of the notes and stock for the value of the notes in excess of the principal amount of the notes, as defined in the convertible debt agreement. We believe the number of shares to be issued upon conversion does not pose a reasonable likelihood of potential significant dilution over the next twelve months. For further information on our Convertible Notes, see Note 8 to our Consolidated Financial Statements.

In addition, there are 2.2 million stock options outstanding to purchase DRS common stock at a weighted average exercise price of $36.50 per share and 0.6 million of non-vested stock awards outstanding at December 31, 2007 that represent additional potential dilution.

We have not entered into any other off-balance sheet financing arrangements.

Contractual Obligations Our contractual obligations and commitments principally include obligations associated with our outstanding indebtedness, future minimum operating lease obligations, acquisition earn-outs and purchase obligations. Except as discussed below, the disclosures relating to our contractual obligations in our Annual Report on Form 10-K for the year ended March 31, 2007 have not changed materially since we filed that report. Based upon the expiration of statutes of limitations and/or the conclusion of tax examinations in several jurisdictions, we believe it is reasonably possible that the total amount of liability for unrecognized tax benefits may decrease by up to $5.1 million within twelve months of December 31, 2007. We are unable to reasonably determine any amounts for years subsequent to December 31, 2008. See Note 3, Income Taxes in the notes to the unaudited condensed consolidated financial statements contained in this report.

Backlog Funded backlog represents products or services that our customers have committed by contract to purchase from us. Due to the general nature of defense procurement and contracting, the operating cycle for our military business typically has been long term. Military backlog currently consists of various production and engineering development contracts with varying delivery schedules and project timetables. Our backlog also includes certain commercial off-the-shelf (COTS)-based systems for the military, which have shorter delivery times. Accordingly, revenues for a particular year,

or year-to-year comparisons of reported revenues and related backlog positions, may not be indicative of future results. Backlog at December 31, 2007 was $3.60 billion, as compared with $3.04 billion at March 31, 2007. We booked $857.9 million and $2.91 billion in new orders for the three- and nine-month periods ended December 31, 2007.

Internal Research and Development In addition to customer-funded research and development, we also engage in internal research and development. These expenditures reflect our continued investment in new technology and diversification of our products. Expenditures for internal research and development for the three-month periods ended December 31, 2007 and 2006 were $14.9 million and $12.6 million, respectively, and $40.4 million and $37.9 million for the nine-month periods ended December 31, 2007 and 2006, respectively.

Use of Non-GAAP Financial Measures Certain disclosures in this document include "non-GAAP (Generally Accepted Accounting Principles) financial measures." A non-GAAP financial measure is defined as a numerical measure of our financial performance that excludes or includes amounts so as to be different than the most directly comparable measure calculated and presented in accordance with GAAP in our Consolidated Balance Sheets, Statements of Earnings or Statements of Cash Flows. The components of EBITDA and a reconciliation of EBITDA and "free cash flow" with the most directly comparable GAAP measure follows:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2007	**2006**	**2007**	**2006**
		(in thousands)		
Net Earnings	$ 42,621	$ 35,094	$ 87,305	$ 81,583
Income taxes	22,296	11,575	43,832	40,906
Interest income	(574)	(370)	(1,513)	(868)
Interest and related expenses	27,401	30,268	84,217	90,789
Depreciation and amortization	19,903	18,759	57,263	57,122
EBITDA(A)	111,647	95,326	271,104	269,532
Income taxes	(22,296)	(11,575)	(43,832)	(40,906)
Interest income	574	370	1,513	868
Interest and related expenses	(27,401)	(30,268)	(84,217)	(90,789)
Deferred income taxes	1,161	(1,124)	4,946	2,959
Changes in assets and liabilities, net of effects from business combinations and divestitures	(11,809)	(28,031)	(73,316)	(93,466)
Other, net	5,904	4,627	42,323	13,456
Net cash provided by operating activities	57,780	29,325	118,521	61,654
Capital expenditures	(16,293)	(10,895)	(48,790)	(38,113)
Free cash flow(B)	$ 41,487	$ 18,430	$ 69,731	$ 23,541

(A) We define EBITDA as net earnings before net interest and related expenses (principally amortization and write-off of debt premium and issuance costs), income taxes, depreciation and amortization. The table above presents the components of EBITDA and a reconciliation of EBITDA to net cash provided by operating activities. EBITDA is presented as additional information because we believe it to be a useful indicator of our debt capacity and our ability to service our debt. EBITDA is not a substitute for operating income, net earnings or cash flows from operating activities, as determined in accordance with GAAP. EBITDA is not a complete net cash flow measure because EBITDA is a measure of liquidity that does not reflect cash flows from discontinued operations, and does not include reductions for cash payments for an entity's obligation to service debt, fund working capital, business acquisitions and capital expenditures, and

pay income taxes. Rather, EBITDA is one potential indicator of an entity's ability to fund these cash requirements. EBITDA also is not a complete measure of an entity's profitability because it does not include costs and expenses for depreciation and amortization, interest and related expenses and income taxes, and it also does not include the results of operations of discontinued operations. EBITDA, as we define it, may differ from similarly named measures used by other entities and, consequently, could be misleading unless all entities calculate and define EBITDA in the same manner.

(B)

Free cash flow is defined as net cash provided by operating activities less capital expenditures. We disclose free cash flow because we believe that it is useful in evaluating our financial performance and measuring cash flows generated that are available for investing and financing activities. We believe that the most directly comparable GAAP financial measure to free cash flow is net cash provided by operating activities. Free cash flow represents cash generated after paying for interest on borrowings, income taxes, capital expenditures and changes in working capital, but before repaying outstanding debt, investing cash to acquire businesses and making other strategic investments, and it does not reflect cash flows of discontinued operations. Thus, key assumptions underlying free cash flow are that we will be able to refinance our existing debt when it matures with new debt and that we will be able to finance any new acquisitions we make by raising new debt or equity capital. We also use free cash flow as a performance measure and a component of our management incentive compensation program. Free cash flow, as we define it, may differ from similarly named measures used by other entities and, consequently, could be misleading unless all entities calculate and define free cash flow in the same manner.

OTHER MATTERS

New Accounting Pronouncements

New accounting pronouncements have been issued, which are not effective until after December 31, 2007. For further discussion of new accounting standards, see Note 18 to our Consolidated Financial Statements in Item 1.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market Risk

See Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk," of the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2007 for a discussion of the Company's exposure to market risks.

Item 4. Controls and Procedures

(a) Disclosure Controls and Procedures The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act.

(b) Internal Control Over Financial Reporting There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the three months ended December 31, 2007 that materially have affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Various legal actions, claims, assessments and other contingencies, including certain matters described below, are pending against us and certain of our subsidiaries. These matters are subject to many uncertainties, and it is possible that some of these matters ultimately could be decided, resolved or settled adversely. We have recorded accruals totaling $3.0 million at both December 31, 2007 and March 31, 2007 for losses related to those matters that we consider to be probable and that can be reasonably estimated (certain legal and environmental matters are discussed in detail below). Although, at December 31, 2007, the precise amount of liability that may result from those matters for which we have recorded accruals is not ascertainable, we believe that any amounts exceeding our recorded accruals should not materially affect our financial condition or liquidity. It is possible, however, that the ultimate resolution of those matters could result in a material adverse effect on our results of operations and/or cash flows from operating activities for a particular reporting period.

Some environmental laws, such as the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (also known as CERCLA or the Superfund law) and similar state statutes, can impose liability for the entire cost of the clean up of contaminated sites upon any of the current or former site owners or operators (or upon parties who send waste to these sites), regardless of the lawfulness of the original activities that led to the contamination. In July 2000, prior to its acquisition by Integrated Defense Technologies Inc. (IDT) and prior to our acquisition of IDT, Tech-Sym Corporation received a Section 104(e) Request for Information from the National Park Service (NPS), pursuant to CERCLA, regarding a site known as the Orphan Mine site in the Grand Canyon National Park, Arizona, which is the subject of an NPS investigation regarding the presence of residual radioactive materials and contamination. A corporation of which Tech-Sym is an alleged successor operated this uranium mine from 1956 to 1967 and owned it for the majority of such time. We believe that there are other potentially responsible parties (PRPs) for the environmental conditions at the site, including the U.S. government as owner, operator and arranger at the site. The potential liability associated with this matter can change substantially, due to such factors as additional information on the nature or extent of contamination, methods of remediation that might be recommended or required, changes in the apportionment of costs among the responsible parties and other actions by governmental agencies or private parties.

In connection with our acquisition of ESSI in January 2006, we have been made aware of certain legal actions, claims, assessments and other contingencies, including those described below.

In December 2004, ESSI was notified by the Enforcement Division of the SEC of the issuance of a formal order directing a private investigation and was notified that the SEC had issued subpoenas to various individuals associated with ESSI to produce certain documents. The SEC staff also requested that ESSI produce certain documents in connection with the investigation. The subpoenas related to trading in ESSI stock around ESSI's earnings releases in 2003 and to the adequacy of certain disclosures made by ESSI regarding related-party transactions in 2002 and 2003 involving insurance policies placed by ESSI through an insurance brokerage firm in which an ESSI director was a principal at the time of the transactions. In February 2007, the SEC filed a civil injunctive action in the United States District Court for the Eastern District of Missouri, Eastern Division, against a former director, officer and consultant of ESSI, alleging that he had violated the federal securities laws by "tipping" his financial advisor and close friend by sharing material, nonpublic information regarding ESSI's financial condition shortly before certain 2003 earnings announcements.

On or about September 23, 2005, the SEC staff advised ESSI's counsel that it had issued a subpoena directed to ESSI and expanded its investigation to include ESSI's disclosure of a November 2004 stop work order relating to ESSI's Deployable Power Generation and Distribution Systems (DPGDS) program for the U.S. Air Force and relating to trading in ESSI stock by certain

individuals associated with ESSI. In connection with the foregoing SEC investigation, ESSI and certain of its directors and officers have provided information and/or testimony to the SEC.

In January 2006, ESSI was informed that the Office of the U.S. Attorney for the Eastern District of Missouri was initiating an investigation into ESSI's disclosure of the DPGDS stop-work order and into trading in ESSI stock by ESSI insiders, which preceded such disclosure. The U.S. Attorney's office advised ESSI that, although it considered ESSI to be a subject of its investigation, ESSI was not a target. In connection with this investigation, the U.S. Attorney's office issued ESSI a subpoena requesting specified information, which ESSI has furnished.

In May 2006, we were advised that the Enforcement Division of the SEC and the U.S. Attorney's office each had expanded its investigation to include possible "backdating" of the timing of option grants at ESSI prior to the time ESSI was acquired by us. As a part of its investigation, the SEC issued subpoenas to certain former officers and employees of ESSI to provide testimony and produce certain documents.

In February 2007, the SEC filed civil injunctive actions in the United States District Court for the Eastern District of Missouri, Eastern Division, alleging that ESSI's former Chief Financial Officer and former Controller had each participated in a backdating scheme. Also in February 2007, the SEC reported that ESSI's former Controller had settled its action against him by consenting to disgorgement, financial penalties, an officer and director bar and a permanent suspension from practicing before the SEC as an accountant. In July 2007, the SEC filed civil injunctive actions in the United States District Court for the Eastern District of Missouri, Eastern Division, alleging that ESSI's former Chairman of the Board and Chief Executive Officer and his son (who was also a member of ESSI's Board of Directors and Compensation Committee) each participated in a backdating scheme.

In March 2007, ESSI's former Controller pleaded guilty to a one-count information brought by the office of the United States Attorney for the Eastern District of Missouri, charging him with making false statements to the government. In connection with his plea, this former ESSI executive admitted that a number of documents filed by ESSI with the SEC contained the materially false statement that the option price of shares subject to the ESSI stock option plan was the closing price of the stock on the date the options were awarded.

In March 2007, ESSI's former Chief Financial Officer was indicted by the grand jury of the United States District Court for the Eastern District of Missouri relating to the backdating of the timing of stock options at ESSI prior to the time ESSI was acquired by DRS. In July 2007, ESSI's former Chairman of the Board and Chief Executive Officer and his son (who was also a member of ESSI's Board of Directors and Compensation Committee) were each indicted on similar charges. The July 2007 superseding indictment charges these former ESSI officers and directors with twelve counts of fraud based on allegations that they backdated stock options on at least eight occasions between 1996 and 2002. The presiding judge has scheduled the criminal trial against these individuals to commence on September 2, 2008.

Although ESSI continues to be a subject of the U.S. Attorney's office's investigation, the U.S. Attorney's office has advised us that ESSI is not a target. Because the events being investigated occurred prior to the time of our acquisition of ESSI, the U.S. Attorney's office has further advised us that it considers DRS to be a witness, not a subject or target of its investigation.

We are committed to full cooperation with regard to the foregoing investigations and proceedings. We are unable to determine at this time the impact, if any, these matters could have on us.

In September 2006, the Internal Revenue Service commenced an audit of ESSI's Federal tax returns for the tax periods ended October 31, 2004, October 31, 2005 and January 31, 2006. Thereafter, the Internal Revenue Service agreed, subject to Congressional approval, to close these audits based on ESSI's agreement to accept certain proposed adjustments (primarily involving the reversal of certain

compensation deductions taken during these tax years) and a corresponding assessment of approximately $11.3 million (exclusive of interest), which was previously accrued. In September 2007, we received written confirmation from the Congressional Joint Committee on Taxation that it took no exception to the proposed adjustments.

In August 2007, a shareholder derivative complaint was filed in the United States District Court for the Eastern District of Missouri against ESSI's former Chairman of the Board and Chief Executive Officer, his son (who was also a member of ESSI's Board of Directors and Compensation Committee), ESSI's former Chief Financial Officer and ESSI's former Controller relating to the alleged backdating of stock options prior to ESSI's acquisition by DRS. The complaint also contains claims against each of the current members of DRS's Board of Directors relating to the alleged backdating of ESSI stock options and the ESSI acquisition. We believe the claims made against the current DRS Directors are without merit.

In January 2008, we received an inquiry from the Australian Competition and Consumer Commission (ACCC) related to one of our subsidiaries, DRS Training & Control Systems, Inc. The ACCC has requested documents and information regarding allegations of possible anticompetitive activity in violation of the Australian Trade Practices Act. We have commenced an internal investigation involving this matter, but we are currently unable to determine the timing or the impact, if any, that the matter may have on us.

Item 1A. Risk Factors

In addition to the information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended March 31, 2007, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Items 2, 3, 4 and 5 are not applicable and have been omitted.

Item 6. Exhibits

(a) Exhibits

Exhibit No.	Description
10.1	DRS Technologies, Inc. Incentive Compensation Plan, incorporated by reference from DRS's definitive proxy statement filed July 3, 2007
10.2	First Amendment to the DRS Technologies, Inc. Incentive Compensation Plan effective as of November 8, 2007 [Form 10-Q filed November 9, 2007, Exhibit 10.2]
31.1*	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2*	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Filed herewith

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.

/s/ RICHARD A. SCHNEIDER

Richard A. Schneider
Executive Vice President, Chief Financial Officer

Date: February 8, 2008

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