

GLOBAL DEFENSE TECHNOLOGY & SYSTEMS, INC.

Form 10-Q

August 06, 2010

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

(Mark One)

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

For the quarterly period ended June 30, 2010

or

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

For the transition period from _____ to _____

Commission file number 001-34551

Global Defense Technology & Systems, Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

20-4477465

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

1501 Farm Credit Drive, Suite 2300

McLean, VA

(Address of principal executive offices)

22102-5011

(Zip Code)

Registrant's telephone number, including area code:

703-738-2840

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

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of Exchange Act. Check one:

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

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

The number of the Registrant's common shares outstanding on August 5, 2010 was 9,071,812.

GLOBAL DEFENSE TECHNOLOGY & SYSTEMS, INC.

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PART I
FINANCIAL INFORMATION
ITEM 1. Financial Statements
GLOBAL DEFENSE TECHNOLOGY & SYSTEMS, INC.
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
(in thousands, except share and per share amounts)

| | As of June 30, 2010 | As of December 31, 2009 |
|--|------------------------------------|--|
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | \$ 1,738 | \$ 7 |
| Accounts receivable, net | 49,254 | 50,691 |
| Due from affiliates | 364 | 1,109 |
| Prepaid expenses and other current assets | 1,240 | 1,238 |
| Deferred tax assets | 589 | 324 |
| Income taxes receivable | 308 | 3,543 |
| | | |
| Total current assets | 53,493 | 56,912 |
| | | |
| Property and equipment, net | 3,509 | 3,441 |
| Intangible assets, net | 19,140 | 21,268 |
| Goodwill | 24,373 | 24,373 |
| Deferred tax assets | 6,140 | 6,295 |
| Other assets | 442 | 222 |
| | | |
| Total assets | \$ 107,097 | \$ 112,511 |
| | | |
| Liabilities and Stockholders Equity | | |
| Current liabilities | | |
| Accounts payable | \$ 10,286 | \$ 13,040 |
| Accrued expenses | 6,966 | 9,521 |
| Advance payments on contracts | 526 | 517 |
| Interest rate swap liability | | 106 |
| | | |
| Total current liabilities | 17,778 | 23,184 |
| | | |
| Deferred rent | 303 | 289 |
| Bank loans, net of current | | 3,686 |
| | | |
| Total liabilities | 18,081 | 27,159 |
| | | |
| Commitments and contingencies (Note 8) | | |

Stockholders Equity

| | | |
|--|------------|------------|
| Common stock, par value \$0.01 per share, 90,000,000 shares authorized and 9,071,812 and 9,051,812 shares issued and outstanding, respectively | 91 | 91 |
| Additional paid-in capital | 88,685 | 88,178 |
| Retained earnings (accumulated deficit) | 240 | (2,917) |
| | | |
| Total stockholders equity | 89,016 | 85,352 |
| | | |
| Total liabilities and stockholders equity | \$ 107,097 | \$ 112,511 |

(See Accompanying Notes)

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GLOBAL DEFENSE TECHNOLOGY & SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

(in thousands, except share and per share amounts)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|------------------------------------|---------------|----------------------------------|-----------------|
| | 2010 | 2009 | 2010 | 2009 |
| Revenue | | | | |
| Products | \$ 25,232 | \$ 31,332 | \$ 46,486 | \$ 59,010 |
| Services | 23,990 | 22,095 | 48,629 | 44,030 |
| Total revenue | 49,222 | 53,427 | 95,115 | 103,040 |
| | | | | |
| Operating costs and expenses | | | | |
| Cost of revenue products | 18,917 | 26,777 | 36,546 | 49,229 |
| Cost of revenue services | 20,235 | 18,065 | 41,047 | 36,435 |
| Selling, general and administrative expenses | 5,813 | 4,807 | 10,425 | 9,253 |
| Amortization of intangible assets | 722 | 2,089 | 2,128 | 4,178 |
| Total operating costs and expenses | 45,687 | 51,738 | 90,146 | 99,095 |
| | | | | |
| Operating income | 3,535 | 1,689 | 4,969 | 3,945 |
| Other income (expense) | | | | |
| Interest income | 3 | 1 | 6 | 3 |
| Interest expense | (47) | (491) | (55) | (1,000) |
| Income before income taxes | 3,491 | 1,199 | 4,920 | 2,948 |
| Provision for income taxes | (1,428) | (558) | (1,763) | (1,388) |
| Net income | \$ 2,063 | \$ 641 | \$ 3,157 | \$ 1,560 |
| | | | | |
| Earnings per share | | | | |
| Basic | \$ 0.23 | \$ 0.11 | \$ 0.35 | \$ 0.26 |
| Diluted | \$ 0.23 | \$ 0.11 | \$ 0.34 | \$ 0.26 |
| Weighted average common shares outstanding | | | | |
| Basic | 9,036,432 | 6,000,000 | 9,036,432 | 6,000,000 |
| Diluted | 9,150,197 | 6,055,152 | 9,156,163 | 6,027,898 |

(See Accompanying Notes)

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GLOBAL DEFENSE TECHNOLOGY & SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(in thousands)

| | Six Months Ended June 30, | |
|--|----------------------------------|-------------|
| | 2010 | 2009 |
| Cash flows from operating activities | | |
| Net income | \$ 3,157 | \$ 1,560 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities | | |
| Depreciation and amortization | 500 | 497 |
| Amortization of intangible assets | 2,128 | 4,178 |
| Equity-based compensation | 507 | 153 |
| Gain from change in fair value of interest rate swap | (106) | (50) |
| Deferred income taxes | (110) | (818) |
| Change in operating assets and liabilities | | |
| Accounts receivable | 1,437 | (12,986) |
| Due to/from affiliates | 745 | (399) |
| Prepaid expenses and other assets | 5 | (184) |
| Income taxes receivable | 3,235 | 1,404 |
| Accounts payable | (2,754) | 9,218 |
| Accrued expenses | (2,555) | (4,624) |
| Accrued interest on loans from affiliates | | 597 |
| Advance payments on contracts | 9 | (4,001) |
| Deferred rent | 14 | 37 |
| | | |
| Net cash provided by (used in) operating activities | 6,212 | (5,418) |
| | | |
| Cash flows from investing activities | | |
| Purchases of property and equipment | (481) | (681) |
| | | |
| Net cash used in investing activities | (481) | (681) |
| | | |
| Cash flows from financing activities | | |
| Proceeds from overline note | | 3,000 |
| Payments under term loan | | (1,800) |
| Net (payments) borrowings under revolving line of credit | (3,686) | 5,013 |
| Payments of financing costs | (314) | |
| Advances to affiliates | | (1,319) |
| | | |
| Net cash (used in) provided by financing activities | (4,000) | 4,894 |

| | | |
|--|----------|---------|
| Increase (decrease) in cash and cash equivalents | 1,731 | (1,205) |
| Cash and cash equivalents, beginning of period | 7 | 1,422 |
| Cash and cash equivalents, end of period | \$ 1,738 | \$ 217 |

Supplemental disclosure of cash flow information

Cash paid (received) during the year for:

| | | |
|--------------|------------|--------|
| Income taxes | \$ (1,362) | \$ 801 |
| Interest | \$ 55 | \$ 405 |

(See Accompanying Notes)

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Global Defense Technology & Systems, Inc.
Unaudited Notes to Consolidated Financial Statements
(in thousands, except share and per share amounts)

Except as otherwise indicated, or as the context otherwise requires, the Company, GTEC, we, us, and our refer to Global Defense Technology & Systems, Inc., a Delaware corporation, and, where appropriate, its direct and indirect subsidiaries, Global Strategies Group (North America) Inc., our operating company, which we refer to as GNA, and The Analysis Corp.

1. Basis of Presentation

The accompanying unaudited consolidated financial statements of GTEC have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. As a result, certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted. In the opinion of management, the accompanying unaudited interim consolidated financial statements reflect all necessary adjustments (all of which are of a normal, recurring nature) that are necessary for a fair presentation of the results for such periods. The information disclosed in the notes to the financial statements for these periods is unaudited. For further information, refer to the financial statements and footnotes included in GTEC's Annual Report on Form 10-K for the year ended December 31, 2009, as filed with the Securities and Exchange Commission (SEC). The current period's results of operations are not necessarily indicative of results that may be achieved for any future period.

2. Business Overview

GTEC is a diversified technology and engineering services firm that provides mission-critical technology-based systems, solutions and services for national security agencies and programs of the U.S. government. The Company's offerings include software engineering services, network and communications management technology, decision support systems for command and control, maritime navigation systems, counter-terrorism intelligence and analysis, data analysis and fusion tools, identifying management solutions and providing innovative expeditionary systems to support troop mobility and survivability worldwide. We derived 82% and 88% of our revenue as a prime contractor for the six months ended June 30, 2010 and year ended December 31, 2009, respectively. Department of Defense provided 69% and 75% of total revenue for the six months ended June 30, 2010 and year ended December 31, 2009, respectively.

3. Accounts Receivable

A summary of accounts receivable follows:

| | As of June 30, 2010 | As of December 31, 2009 |
|--|------------------------------------|--|
| Billed | \$ 8,294 | \$ 14,842 |
| Unbilled | | |
| Billable | 13,734 | 13,288 |
| Revenues in excess of billing milestones and other | 27,331 | 22,668 |
| Total unbilled | 41,065 | 35,956 |
| Total accounts receivable | 49,359 | 50,798 |
| Less: allowance for doubtful accounts | (105) | (107) |
| Total accounts receivable, net | \$ 49,254 | \$ 50,691 |

4. Bank Loans

On February 3, 2010, the Company together with its subsidiaries (collectively as Borrowers) and its existing lender replaced its existing credit facility of \$29,000 with a new credit facility of up to \$50,000, including the extension of letters of credit up to an aggregate of \$2,500. The new facility matures on January 31, 2013. All borrowings continue to be collateralized by substantially all of the Company's assets. Loans under the facility take the form of, at the Company's election, an index rate loan, a base rate loan, or a LIBOR loan, with the interest rate determined by the form of the loan. An index rate loan will bear interest at a rate equal to the one-month LIBOR plus the applicable margin. A base rate loan will bear interest at a rate equal to the highest of the prime rate, the federal funds rate plus 50 basis points, or the one-month LIBOR, each plus the applicable margin. A LIBOR loan will bear interest at a rate equal to the one-, two-, three- or six-month LIBOR plus the applicable margin. For all loans, the applicable margin adjusts quarterly based on the Borrowers' funded debt ratio. The maximum applicable margin is 3.00%. The funded debt ratio is the ratio of debt to EBITDA for the Borrowers and their subsidiaries on a consolidated basis. The Company is required to meet certain financial and other covenants, including but not limited to, a Minimum Net Worth test, a Fixed Charges Coverage Ratio and a Maximum Funded Debt Ratio, as defined in the agreement. The Company was in compliance with the affirmative and restrictive covenants at June 30, 2010. At December 31, 2009, we had \$3,686 outstanding on our revolving line of credit and we had no debt outstanding at June 30, 2010.

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Effective November 25, 2009, the Company adopted the Global Defense Technology & Systems, Inc., 2009 Performance Incentive Plan, which we refer to as the Plan. The Plan authorizes the issuance of options to purchase shares of common stock and the grant of bonus stock awards, restricted common stock awards, stock appreciation rights, deferred shares, performance shares and performance units. Options previously granted by GNA under the SFA Inc. 2007 Stock Option Plan, which we refer to as the SFA Plan, have been assumed under the Plan.

As of June 30, 2010, the maximum number of shares of common stock that may be subject to awards is 1,125,000, including the 492,127 shares of common stock issuable upon exercise of options granted under the SFA Plan and assumed under the Plan. A compensation committee made up of members of the Company's Board of Directors administers the plan. As of June 30, 2010, the Plan had 271,308 shares available for future grants. The options generally vest on a straight-line basis over 4 years and expire after 10 years.

On January 4, 2010, the Company granted 20,000 shares of restricted stock to our Chief Executive Officer that vest over a three year period with a grant date fair value of \$327 based on the price of the stock at the date of grant. The weighted average remaining life of all outstanding restricted stock is 2.5 years as of June 30, 2010.

The following table reflects the restricted stock activity:

| | Shares | Weighted- Average Price |
|----------------------------------|---------------|------------------------------------|
| Shares granted | 15,380 | \$ 14.37 |
| Outstanding at December 31, 2009 | 15,380 | \$ 14.37 |
| Shares granted | 20,000 | \$ 16.37 |
| Outstanding at June 30, 2010 | 35,380 | \$ 15.50 |
| Vested at June 30, 2010 | | |

The following table summarizes stock option activity:

| | Options | Weighted- Average Exercise Price |
|--|----------------|---|
| Options outstanding at December 31, 2008 | 468,355 | \$ 9.75 |
| Options granted | 259,087 | \$ 14.46 |
| Options exercised | | |
| Options forfeited | (166,131) | 9.57 |
| Options outstanding at December 31, 2009 | 561,311 | \$ 10.18 |
| Options granted | 257,001 | \$ 14.35 |
| Options exercised | | |
| Options forfeited | | |

| | | | |
|--------------------------------------|---------|----|-------|
| Options outstanding at June 30, 2010 | 818,312 | \$ | 11.49 |
|--------------------------------------|---------|----|-------|

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The following table summarizes stock option vesting and unvested options:

| | Options | Weighted- Average Fair Value | Weighted Average Exercise Price |
|-------------------------------|----------------|---|--|
| Unvested at December 31, 2008 | 385,016 | \$ 4.39 | \$ 9.88 |
| Vested at December 31, 2008 | 83,339 | \$ 4.49 | \$ 9.17 |
| Granted | 259,087 | \$ 4.86 | \$ 14.46 |
| Vested | (54,175) | 4.22 | 10.43 |
| Forfeited | (166,131) | 4.24 | 9.57 |
| Unvested at December 31, 2009 | 423,797 | \$ 4.64 | \$ 11.27 |
| Vested at December 31, 2009 | 137,514 | \$ 4.39 | \$ 6.82 |
| Granted | 257,001 | \$ 4.98 | \$ 14.35 |
| Vested | (89,282) | 4.76 | 13.37 |
| Forfeited | | | |
| Unvested at June 30, 2010 | 591,516 | \$ 4.77 | \$ 12.29 |
| Vested at June 30, 2010 | 226,796 | \$ 4.54 | \$ 9.40 |

Stock based compensation is recognized on a straight-line basis over the requisite vesting period using a Black-Scholes-Merton option pricing model. The Company recognizes the effect of expected forfeitures of equity awards by estimating an expected forfeiture rate. Amounts recognized for expected forfeitures are subsequently adjusted quarterly at major vesting dates to reflect actual forfeitures.

All issuances of stock options utilized an exercise price equal to the fair value of the Company's common stock on the grant date. Prior to our initial public offering, the fair value of the common stock was determined by management with requisite valuation expertise and was performed on a contemporaneous basis at or near the award grant date.

Determining the fair value of common stock requires making complex and subjective judgments. Management used the market approach to estimate the Company's enterprise value at each date at which options were granted. There is inherent uncertainty in market multiple estimates. The enterprise value was then used to determine the fair value of the Company's common stock and utilized in calculating stock-based compensation.

After completion of our initial public offering, the exercise price is equal to the closing price listed on Nasdaq Global Markets on the day of grant.

As of June 30, 2010, there was approximately \$2,175 of unrecognized stock-compensation expense related to unvested stock options, which is expected to be recognized over a weighted average period of 2.9 years.

6. Earnings Per Share

Basic earnings per share, or EPS, exclude dilution and are computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted EPS reflect potential dilution that could occur from potential common stock outstanding during the period. Potential common stock, for purposes of determining diluted EPS, includes the effects of dilutive restricted stock and stock options. The effect of such potential common stock is computed using the treasury stock method or the if-converted method, as applicable.

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The following table presents a reconciliation of the numerators and denominators of the basic and diluted EPS computations for net income. In the table below, income represents the numerator and weighted-average shares represent the denominator:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|------------------------------------|-------------|----------------------------------|-------------|
| | 2010 | 2009 | 2010 | 2009 |
| Net income | \$ 2,063 | \$ 641 | \$ 3,157 | \$ 1,560 |
| Weighted average basic shares outstanding | 9,036,432 | 6,000,000 | 9,036,432 | 6,000,000 |
| Effect of dilutive shares: | | | | |
| Assuming exercise of stock options | 110,415 | 55,152 | 106,638 | 27,898 |
| Restricted shares | 3,350 | | 13,093 | |
| Weighted average dilutive shares outstanding | 9,150,197 | 6,055,152 | 9,156,163 | 6,027,898 |
| Basic earnings per share | \$ 0.23 | \$ 0.11 | \$ 0.35 | \$ 0.26 |
| Diluted earnings per share | \$ 0.23 | \$ 0.11 | \$ 0.34 | \$ 0.26 |

In addition, employee stock options should have a dilutive effect only when the average market price of the common stock during the period exceeds the exercise price of the options. As such, 199,514 and 77,527 options for the six months ended June 30, 2010 and 2009, respectively, and 100,796 options for the three months ended June 30, 2009, were excluded from the Company's earnings per share calculations due to their anti-dilutive impact.

7. Related Party Transactions

GNA provides subcontracting services as well as support for security, information technology and other administrative services to its affiliate, Global Strategies Group Holding, S.A. and its subsidiaries (referred to collectively as GLOBAL).

Included in revenue are services rendered to GLOBAL for the six months ended June 30, 2010 and 2009 in the amount of \$786 and \$1,218, respectively. Included in due from affiliates related to these services at June 30, 2010 and December 31, 2009 are \$247 and \$350, respectively.

Also included in due from affiliates are amounts provided by GNA to Global Strategies Group (Integrated Security), Inc. (GIS), an affiliate of GLOBAL, as short-term advances for payroll and operating expenses. As of June 30, 2010 and December 31, 2009, accounts receivable from GIS for such advances were \$117 and \$759, respectively.

Included in selling, general and administrative expense are services rendered by GLOBAL for corporate management and certain administrative expenses to the Company for the six months ended June 30, 2009 in the amount of \$1,069. These services ceased upon completion of our initial public offering in November 2009.

8. Contingencies

From time to time, we are involved in legal proceedings arising in