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

# FORM 10-Q

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

| | |
|---|---|
| **For the Quarter Ended:** | **Commission File Number:** |
| June 30, 2000 | 333-36447 |

# FEDERAL DATA CORPORATION
(Exact name of Registrant as specified in its charter)

| | |
|---|---|
| **DELAWARE** | **52-0940566** |
| (State or other jurisdiction of incorporation) | (I.R.S. Employer Identification Number) |

**4800 Hampden Lane, Bethesda, MD 20814**
(Address of principal executive offices) (Zip Code)

**(301) 986-0800**
(Registrant's telephone number, including area code)

**Not Applicable**
(Former name, former address, and former fiscal year, if changed since last report)

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 [X] No [ ]

As of the close of business July 31, 2000, the Registrant had outstanding 2,917,996 shares of Common Stock, par value $.01 per share.

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Part I. Financial Information

Item 1. Consolidated Financial Statements.

**Federal Data Corporation**
**Consolidated Balance Sheets**
**(In thousands, except share data)**

| | December 31, 1999 | June 30, 2000 |
|---|---|---|
| Assets | | (Unaudited) |
| Cash and cash equivalents | $4,095 | $1,298 |
| Accounts receivable | 129,774 | 130,564 |
| Net investment in sales-type leases | 5,672 | 4,281 |
| Inventory | 6,020 | 9,590 |
| Other assets | 3,317 | 4,740 |
| Total current assets | 148,878 | 150,473 |
| Net investment in sales-type leases | 2,714 | 2,433 |
| Leased and other property and equipment | 6,071 | 6,837 |
| Goodwill and intangibles | 57,718 | 54,378 |
| Other assets | 10,783 | 10,339 |
| Total assets | $226,164 | $224,460 |
| Liabilities and stockholders' deficit | | |
| Accounts payable and other liabilities | $95,667 | $89,250 |
| Recourse notes payable | 2,000 | - |
| Nonrecourse obligations under capital leases | 1,691 | 730 |
| Total current liabilities | 99,358 | 89,980 |
| Recourse notes payable | 131,000 | 142,940 |
| Other liabilities | 2,058 | 1,789 |
| Total liabilities | 232,416 | 234,709 |
| Stockholders' deficit | | |
| Common stock, $.01 par value: 8,000,000 shares authorized; 2,932,196 shares issued and 2,917,996 outstanding in 1999 and 2000 | 29 | 29 |
| Capital in excess of par value | 43,968 | 44,070 |
| Accumulated deficit | (50,249) | (54,348) |
| Total stockholders' deficit | (6,252) | (10,249) |
| Commitments and contingencies | | |
| Total liabilities and stockholders' deficit | $226,164 | $224,460 |

See notes to consolidated financial statements

**Federal Data Corporation**
**Consolidated Statements of Operations**
**(In thousands)**
**(Unaudited)**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 1999 | 2000 | 1999 | 2000 |
| Revenue | | | | |
| Product sales | $109,017 | $101,148 | $171,667 | $181,892 |
| Professional and support services | 42,901 | 44,270 | 83,015 | 81,253 |
| Interest and other | 287 | 412 | 734 | 1,070 |
| Total revenue | 152,205 | 145,830 | 255,416 | 264,215 |
| Expenses | | | | |
| Cost of sales and services | 136,337 | 130,644 | 226,255 | 235,990 |
| Selling, general and administrative | 10,837 | 11,210 | 22,336 | 22,402 |
| Goodwill and intangibles | 2,329 | 1,614 | 5,125 | 3,348 |
| Interest | 4,018 | 4,094 | 7,884 | 8,017 |
| Total expenses | 153,521 | 147,562 | 261,600 | 269,757 |
| Loss before income tax benefit | (1,316) | (1,732) | (6,184) | (5,542) |
| Income tax benefit | (45) | (316) | (1,315) | (1,443) |
| Net loss | ($1,271) | ($1,416) | ($4,869) | ($4,099) |

See notes to consolidated financial statements

**Federal Data Corporation**
**Consolidated Statements of Cash Flows**
**(In thousands)**
**(Unaudited)**

| | Six Months Ended June 30, | |
|---|---|---|
| | 1999 | 2000 |
| Cash flows from operating activities: | | |
| Net loss | ($4,869) | ($4,099) |
| Adjustments to reconcile net loss to net cash flows from operating activities: | | |
| Depreciation and amortization | 6,404 | 4,617 |
| Amortization of deferred financing costs | 474 | 475 |
| Non-cash compensation related to stock options | 1,274 | 102 |
| Gain on sale of assets | (125) | - |
| Income recorded on sales-type leases | (617) | (397) |
| Collections from sales-type leases | 4,298 | 3,274 |
| Increase in inventory | (1,819) | (3,570) |
| Increase in accounts receivable | (12,419) | (790) |
| Decrease in accounts payable and accrued expenses | (568) | (5,007) |
| Net change in other assets and liabilities | 3,376 | (3,201) |
| Net cash flows from operating activities | (4,591) | (8,596) |
| Cash flows from investing activities: | | |
| Net proceeds from sale of property and equipment | 488 | - |
| Purchase of equipment for sales-type leases | (3,176) | (1,154) |
| Purchase of property and equipment | (1,317) | (2,035) |
| Net cash flows from investing activities | (4,005) | (3,189) |
| Cash flows from financing activities: | | |
| Net borrowings under line of credit | 9,000 | 12,000 |
| Proceeds from sale of common stock | 9 | - |
| Repayments of borrowings | - | (2,000) |
| Repayments of capital lease obligations | (1,013) | (1,012) |
| Net cash flows from financing activities | 7,996 | 8,988 |
| Net change in cash and cash equivalents | (600) | (2,797) |
| Cash and cash equivalents, beginning of period | 3,942 | 4,095 |
| Cash and cash equivalents, end of period | $3,342 | $1,298 |

See notes to consolidated financial statements

**Federal Data Corporation**
**Notes to Consolidated Financial Statements**
**(In thousands, except share data)**
**(Unaudited)**

## Note 1 – Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of Federal Data Corporation and its wholly-owned subsidiaries (collectively, the Company) and have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in the annual financial statements, prepared in accordance with generally accepted accounting principles, have been condensed or omitted pursuant to those rules and regulations, although the Company believes that the disclosures made are adequate to make the information presented not misleading.

In the opinion of management, the accompanying unaudited consolidated financial statements reflect all necessary adjustments and reclassifications (all of which are of a normal, recurring nature) that are necessary for fair presentation for the periods presented. It is suggested that these unaudited consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's latest annual report to the Securities and Exchange Commission on Form 10-K 405 for the year ended December 31, 1999.

The results of operations for the three months and six months ended June 30, 2000, are not necessarily indicative of the results to be expected for the full fiscal year ending December 31, 2000.

All of the Company's direct and indirect wholly-owned subsidiaries have fully and unconditionally guaranteed, on a joint and several basis, the Company's obligations under its Senior Subordinated Notes. The Company is a holding company with no assets or operations other than its investments in its subsidiaries. The separate financial statements of the subsidiary guarantors are not presented because the Company's management believes that such financial statements are not material to investors.

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## Note 2 – Recent Accounting Pronouncements

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin 101 (SAB 101), “Revenue Recognition in Financial Statements” which summarizes certain of the staff’s views on revenue recognition. The Company’s revenue recognition policies have been and continue to be in accordance with SAB 101.

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## Note 3 – Reclassification

Certain amounts have been reclassified in the prior period to conform to the current period presentations. These reclassifications had no effect on net loss or retained earnings as previously reported.

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**Note 4 – Stockholders' Equity**

In December 1995, FDC Holdings, Inc. merged with and into the Company with the Company continuing as the surviving corporation. In accordance with the merger agreement, the Company was to replace options previously outstanding at the merger date with options in the surviving corporation that provide substantially the same economic benefit to the option holder as the benefits provided prior to the merger. To fulfill this obligation, in March 1999, the Company issued fully vested options to purchase 40,425 shares of the Company's common stock at an exercise price of $2.00 per share. These options expire ten years from the date of grant. Accordingly, the Company recorded non-cash compensation of $1,011 and a related increase in capital in excess of par value based on the difference between the exercise price of the stock options and the then current fair market value.

During the six months ended June 30, 2000, the Company issued options to purchase 43,000 shares of the Company's common stock at an exercise price of $27.00 per share.

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

### RESULTS OF OPERATIONS

### THREE MONTHS ENDED JUNE 30, 2000 COMPARED WITH THREE MONTHS ENDED JUNE 30, 1999

The following table sets forth, for the periods indicated, selected consolidated statements of operations data as a percentage of total revenue:

| | Three Months Ended June 30, | |
|---|---|---|
| | 1999 | 2000 |
| Revenue | | |
| Product sales | 71.6 % | 69.4 % |
| Professional and support services | 28.2 | 30.3 |
| Interest and other | 0.2 | 0.3 |
| Total revenue | 100.0 | 100.0 |
| Expenses | | |
| Cost of sales and services | 89.6 | 89.6 |
| Selling, general and administrative | 7.1 | 7.7 |
| Goodwill and intangibles | 1.5 | 1.1 |
| Interest | 2.7 | 2.8 |
| Total expenses | 100.9 | 101.2 |
| Loss before income tax benefit | -0.9 % | -1.2 % |

## REVENUE

Revenue for the three months ended June 30, 2000 was $145.8 million, down $6.4 million or 4% from the comparable period of 1999. During the three months ended June 30, 1999, the Company recorded a significant sale of networking products to the U.S. Navy aggregating $25.5 million. Excluding the effect of this transaction, revenue increased $19.1 million or 15% over the comparable period of 1999. Revenue from product sales was $101.1 million, down $7.9 million or 7% from the comparable period of 1999. Excluding the effect of the U.S. Navy transaction, revenue from product sales increased $17.6 million or 21% over the comparable period of 1999. This increase in revenue from product sales is primarily due to increased volume as a result of repeat customer business, partner referrals, outbound solicitation and electronic commerce. Revenue from professional and support services was $44.3 million, up $1.4 million or 3% over the comparable period of 1999.

## GROSS MARGIN

Gross margin is revenue from product sales and professional and support services less cost of sales and services, which includes product purchase costs, personnel and other professional and support services costs. The Company's gross margin for the three months ended June 30, 2000 was $14.8 million, down $0.8 million or 5% from the comparable period of 1999. The Company's gross margin percentages vary over time and change depending on the product sold, the contract vehicle used and the portion of the work performed by Company personnel versus subcontractors. Gross margin as a percentage of product sales and professional and support services revenue for the three months ended June 30, 2000 was 10.2% compared with 10.3% for the comparable period of 1999.

## SELLING, GENERAL AND ADMINISTRATIVE EXPENSE

Selling, general and administrative expense for the three months ended June 30, 2000 was $11.2 million, up $0.4 million or 3% over the comparable period of 1999. Selling, general and administrative expense for the three months ended June 30, 2000 was 7.7% of revenue compared with 7.1% of revenue for the comparable period of 1999.

## AMORTIZATION OF GOODWILL AND INTANGIBLES

The excess of the cost of acquisitions over the fair value of identifiable net tangible and intangible assets acquired was $65.0 million and is being amortized on a straight-line basis over fifteen years. The present value of the contract profits of $16.5 million acquired in acquisitions is being amortized over the remaining terms of the acquired contracts in relation to the recognition of related contract revenue. Other identified intangibles including covenants not to compete, work force and trade names and trademarks of $5.1 million acquired in acquisitions are being amortized over periods up to three years. Amortization of goodwill and intangibles for the three months ended June 30, 2000 was $1.6 million, down $0.7 million or 31% from the comparable period of 1999, primarily due to the reduction in the amortization of the present value of contract profits acquired through the acquisitions.

## INTEREST EXPENSE

Interest expense for the three months ended June 30, 2000 was $4.1 million, up $0.1 million or 2% over the comparable period of 1999.

## INCOME TAX BENEFIT

The income tax benefit for the three months ended June 30, 2000 is based on an estimated annual effective rate, excluding expenses not deductible for income tax purposes. Before giving effect to the non-deductibility of the amortization of goodwill and the value assigned to other identified intangibles associated with certain acquisitions and the non-cash compensation related to stock options, the effective tax provision rate for the year ending December 31, 2000 is estimated to be 40%, approximately the same rate recorded during the three months ended June 30, 1999.

**NET LOSS**

Net loss for the three months ended June 30, 2000 was $1.4 million, a $0.1 million increase or 11% from the net loss of $1.3 million recorded in the comparable period of 1999 based on the reasons discussed above.

**RESULTS OF OPERATIONS**

**SIX MONTHS ENDED JUNE 30, 2000 COMPARED WITH SIX MONTHS ENDED JUNE 30, 1999**

The following table sets forth, for the periods indicated, selected consolidated statements of operations data as a percentage of total revenue:

| | Six Months Ended June 30, | |
|---|---|---|
| | 1999 | 2000 |
| Revenue | | |
| Product sales | 67.2 % | 68.8 % |
| Professional and support services | 32.5 | 30.8 |
| Interest and other | 0.3 | 0.4 |
| Total revenue | 100.0 | 100.0 |
| Expenses | | |
| Cost of sales and services | 88.6 | 89.3 |
| Selling, general and administrative | 8.7 | 8.5 |
| Goodwill and intangibles | 2.0 | 1.3 |
| Interest | 3.1 | 3.0 |
| Total expenses | 102.4 | 102.1 |
| Loss before income tax benefit | -2.4 % | -2.1 % |

**REVENUE**

Revenue for the six months ended June 30, 2000 was $264.2 million, up $8.8 million or 3% over the comparable period of 1999. During the six months ended June 30, 1999, the Company recorded a significant sale of networking products to the U.S. Navy aggregating $25.5 million. Excluding the effect of this transaction, revenue increased $34.3 million or 15% over the comparable period of 1999. Revenue from product sales was $181.9 million, up $10.2 million or 6% over the comparable period of 1999. Excluding the effect of the U.S. Navy transaction, revenue from product sales increased $35.7 million or 24% over the comparable period of 1999. This increase in revenue from product sales is primarily due to increased volume as a result of repeat customer business, partner referrals, outbound solicitation and electronic commerce. Revenue from professional and support services was $81.3 million, down $1.8 million or 2% from the comparable period of 1999. The decrease in professional and support services revenue is primarily due to the expiration of existing contracts which were originally awarded to acquired companies under small business set-aside programs or contracts which became set-aside programs after their expiration.

**GROSS MARGIN**

Gross margin is revenue from product sales and professional and support services less cost of sales and services, which includes product purchase costs, personnel and other professional and support services costs. The Company's gross margin for the six months ended June 30, 2000 was $27.2 million, down $1.3 million or 4% from the comparable period of 1999. The Company's gross margin percentages vary over time and change depending on the product sold, the contract vehicle used and the portion of the work performed by Company personnel versus subcontractors. Gross margin as a percentage of product sales and professional and support services revenue was 10.3% for the six months ended June 30, 2000, down from 11.2% for the comparable period of 1999. This decrease in gross margin was primarily the result of specific sales and marketing initiatives in the value-added product marketplace during the three months ended March 31, 2000.

**SELLING, GENERAL AND ADMINISTRATIVE EXPENSE**

Selling, general and administrative expense for the six months ended June 30, 2000 was $22.4 million, up $0.1 million over the comparable period of 1999. During the six months ended June 30, 1999, the Company issued stock options in accordance with the Company's merger with FDC Holdings, Inc. in 1995. Accordingly, the Company recorded non-cash compensation of $1.0 million during the six months ended June 30, 1999 and a related increase in capital in excess of par value based on the difference between the exercise price of the stock options and the then current fair market value. Excluding the effect of the non-cash compensation, selling, general and administrative expense for the six months ended June 30, 2000 was 8.5% of revenue compared with 8.3% of revenue for the comparable period of 1999.

**AMORTIZATION OF GOODWILL AND INTANGIBLES**

The excess of the cost of acquisitions over the fair value of identifiable net tangible and intangible assets acquired was $65.0 million and is being amortized on a straight-line basis over fifteen years. The present value of the contract profits of $16.5 million acquired in acquisitions is being amortized over the remaining terms of the acquired contracts in relation to the recognition of related contract revenue. Other identified intangibles including covenants not to compete, work force and trade names and trademarks of $5.1 million acquired in acquisitions are being amortized over periods up to three years. Amortization of goodwill and intangibles for the six months ended June 30, 2000 was $3.3 million, down $1.8 million or 35% from the comparable period of 1999, primarily due to the reduction in the amortization of the present value of contract profits acquired through the acquisitions.

**INTEREST EXPENSE**

Interest expense for the six months ended June 30, 2000 was $8.0 million, up $0.1 million or 2% over the comparable period of 1999.

**INCOME TAX BENEFIT**

The income tax benefit for the six months ended June 30, 2000 is based on an estimated annual effective rate, excluding expenses not deductible for income tax purposes. Before giving effect to the non-deductibility of the amortization of goodwill and the value assigned to other identified intangibles associated with certain acquisitions and the non-cash compensation related to stock options, the effective tax provision rate for the year ending December 31, 2000 is estimated to be 40%, approximately the same rate recorded during the six months ended June 30, 1999.

**NET LOSS**

Net loss for the six months ended June 30, 2000 was $4.1 million, a $0.8 million reduction or 16% from the net loss of $4.9 million recorded in the comparable period of 1999 based on the reasons discussed above.

**LIQUIDITY AND CAPITAL RESOURCES**

Historically, the Company's primary source of liquidity is cash provided by operations and financing activities. In general, the Company's liquidity requirements vary seasonally with revenue, which are historically higher in the third and fourth quarters of each fiscal year. Cash flow from the collection of accounts receivable from the U.S. Government (the Government) has generally been predictable and dependable. Cash and cash equivalents were $1.3 million at June 30, 2000, down $2.8 million from December 31, 1999 primarily as a result of net cash used in operating activities of $8.6 million and net cash used in investing activities of $3.2 million being partially offset by cash generated from financing activities of $9.0 million. Net cash used from operating activities was primarily a result of the decrease in accounts payable and accrued expenses of $5.0 million and an increase in inventory of $3.6 million. Net cash used in investing activities was the result of purchases of property and equipment of $2.0 million and equipment purchased for sales-type leases of $1.2 million. Net cash flow from financing activities was primarily the result of net borrowings under the Company's working capital line of credit of $12.0 million, being partially offset by repayments of other borrowings of $2.0 million. In March 2000, certain financial covenants within the Company's Senior Credit Facility were amended.

EBITDA, as calculated below, represents the sum of loss before income tax benefit, net recourse interest expense, depreciation and amortization and one-time non-cash charges. EBITDA is not a measure of performance or financial condition under generally accepted accounting principles, but is presented to provide additional information related to debt service capability. EBITDA should not be considered in isolation or as a substitute for other measures of financial performance or liquidity under generally accepted accounting principles. While EBITDA is frequently used as a measure of operations and the ability to meet debt service requirements, it is not necessarily comparable to other similarly titled captions of other companies due to the potential inconsistencies in the method of calculation.

The following presentation represents the Company's computation of EBITDA (in thousands):

| | Six Months Ended June 30, | |
|---|---|---|
| | 1999 | 2000 |
| Loss before income tax benefit | ($6,184) | ($5,542) |
| Net recourse interest expense | 7,644 | 7,904 |
| Non-cash compensation related to stock options | 1,274 | 102 |
| Depreciation and amortization | 6,404 | 4,617 |
| EBITDA | $9,138 | $7,081 |

###

**YEAR 2000 COMPLIANCE**

To date, the Company has not experienced any significant failures or disruptions in its internal operating systems or in its dealings with third party suppliers and customers. The Company continues to monitor its infrastructure and its critical business partners to ensure continued Year 2000 compliance. There can be no assurance that the Company will not experience unanticipated negative consequences and/or material costs caused by undetected errors or defects in the technology used in its internal systems, which are comprised of third party products, or by unidentified problems experienced by its suppliers or customers. However, the Company does not believe that a material adverse effect from Year 2000 issues is likely. The Company incurred $0.9 million in connection with Year 2000 compliance, and does not anticipate any significant future costs.

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This quarterly report on Form 10-Q contains statements which, to the extent that they are not recitations of historical fact, constitute "forward-looking statements" that are based on management's expectations, estimates, projections and assumptions. Words such as "expects," "anticipates," "plans," "believes," "estimates," variations of such words and similar expressions are intended to identify such forward-looking statements that include, but are not limited to, projections of future performance, assessment of contingent liabilities and expectations concerning liquidity, cash flow and contract awards. Such forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future performance and involve certain risks and uncertainties that are difficult to predict. Therefore, actual future results and trends may differ materially from what is forecast in forward-looking statements due to a variety of factors, including the Company's successful execution of internal performance plans; performance issues with key suppliers and subcontractors; developments with respect to contingencies such as legal proceedings or administrative proceedings challenging any contract award; labor negotiations; changing priorities or reductions in the budgets of Government agencies who purchase products or services from the Company; termination of Government contracts due to unilateral Government action; and the impact of the “Year 2000” issue on the Company and its customers and suppliers. For additional information, see “Risk Factors” in the Company’s Registration Statement on Form S-4, SEC File Number 333-36447.

The previous discussion and analysis should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this report.

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**Item 3. Quantitative and Qualitative Disclosure about Market Risk**

The Company is exposed to market risk from changes in interest rates due to investments in instruments made for non-trading purposes. The interest rate risk relates primarily to the Company's portfolio of short-term investment grade securities. The Company is also subject to risk relating to fluctuating interest rates under its Senior Credit Facility. The Company believes that interest rate risk is immaterial to the Company.

**Part II. Other Information**

**Item 6 (a). Exhibits**

21.1 Subsidiaries of Federal Data Corporation.

27 Financial Data Schedule.

**Item 6 (b). Reports on Form 8-K**

None.

**SIGNATURE**

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 hereunto duly authorized.

FEDERAL DATA CORPORATION

By: */s/ James M. Dean*

James M. Dean
Vice President, Chief Financial Officer
and Treasurer

Date: August 11, 2000