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

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**FORM 10-K/A  
(Amendment No. 2)**

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**Annual Report pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934**

**For the Year Ended December 31, 2002**

**Commission File Number 0-5404**

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**Analex Corporation**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**71-0869563**  
(I.R.S. Employer Identification Number)

**5904 Richmond Highway, Suite 300  
Alexandria, Virginia 22303**  
(Address of principal executive offices)

**Registrant's telephone number including area code  
(703) 329-9400**

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**Securities registered pursuant to Section 12(b) of the Act:**

| <u>Title of Class</u>                           | <u>Name of exchange on which registered:</u> |
|---|--|
| <b>Common Stock, par value \$0.02 per share</b> | <b>American Stock Exchange</b>               |

**Securities registered pursuant to Section 12(g) of the Act: None**

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act) Yes  No

The aggregate market value of the common stock of the registrant held by non-affiliates of the registrant (based upon the closing price of the common stock on the American Stock Exchange on November 5, 2003) was approximately \$21,434,466.

As of November 5, 2003, 15,032,067 shares of the common stock of the registrant were outstanding.

Documents incorporated by reference. (1) Portions of the registrant's Proxy Statement to be filed in connection with the registrant's 2003 annual meeting of stockholders are incorporated by reference in Part III of this Annual Report pursuant to General Instruction G(3) to Form 10-K.

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## PART I

### **Item 1. Business**

#### **Introduction**

Analex Corporation (“Analex” or the “Company”) specializes in providing information technology, engineering and bio-defense services and solutions in support of our nation’s security. Analex focuses on developing innovative technical approaches for the intelligence community, analyzing and supporting defense systems, designing, developing and testing aerospace systems and developing medical defenses and treatments for infectious agents used in biological warfare and terrorism.

#### **Name Change**

Pursuant to the approval of the Company’s shareholders at the Company’s annual shareholder meeting held on May 21, 2002, Hadron, Inc. changed its name on July 1, 2002 to Analex Corporation by merging Hadron, Inc. into its wholly owned subsidiary Analex Corporation. Hadron acquired Analex on November 5, 2001. Hadron’s name was changed to Analex to improve marketing effectiveness and take advantage of Analex’s broader name recognition in both the intelligence and aerospace systems engineering market segments. Under the resulting corporate structure, Analex Corporation has two wholly owned subsidiaries, SyCom Services, Inc. and Advanced Biosystems, Inc.

#### **Operations**

The Company has two reportable segments: Advanced Biosystems (ABS), which is engaged in biomedical research for broad-spectrum defenses against toxic agents capable of being used as bioterrorist weapons, such as anthrax and smallpox, and Analex, which is engaged in professional services related to information technology and systems engineering for the U.S. government, primarily the Department of Defense. The segments are distinguished by their individual clients, past experience and technical skills.

The segment Analex consists of two businesses groups: the Homeland Security Group and the Systems Engineering Group. The Homeland Security Group provides information technology services, systems integration, hardware and software engineering and independent quality assurance in support of the U.S. intelligence community and Department of Defense. The Systems Engineering Group provides engineering, information technology and program management support to NASA, the Department of Defense, and major aerospace contractors such as Lockheed Martin and Northrop Grumman.

#### ***Analex Segment***

*Homeland Security Group.* Since 1964, the Company has provided hardware and software engineering, systems integration, information technology solutions and independent quality assurance to support the requirements of the U.S. intelligence community. The Homeland Security Group’s role in the support of the intelligence community brings specialized skills to a broad set of technical requirements. In the area of intelligence, reconnaissance and surveillance, it provides solutions that enable the simulation of a realistic operational environment so that satellites and related systems can be tested prior to deployment. Homeland Security performs verification and validation of test results to ensure the reliability of the data and also develops radar, modeling and simulation, and system software, all in support of testing, collecting, and analyzing data from various intelligence systems.

The Homeland Security Group is an independent expert in the design and testing of expendable launch vehicles for the Department of Defense and intelligence community. Its highly specialized expertise provides test analysis and independent validation and verification support in areas such as structural dynamics, trajectory and performance, thermal system performance, and range safety.

Homeland Security provides independent validation and verification services to the United States Air Force and the National Reconnaissance Office in support of launches of the Atlas and Titan expendable launch vehicles. The Company’s contribution to the success and reliability of these launches has earned two prestigious

awards: the Defense Department's David Packard Excellence in Acquisition Award, and the National Reconnaissance Office's Gold Medal Award.

Homeland Security supports other intelligence agencies such as the National Security Agency and the Central Intelligence Agency by providing software development, systems integration, configuration management and network administration services. In addition, the Company develops and conducts training of military personnel in debriefing and interrogating enemy combatants.

*Systems Engineering Group.* The Systems Engineering Group provides sophisticated professional services to NASA, the Defense Department and major aerospace contractors such as Lockheed Martin and Northrop Grumman. The Company provides engineering and information technology services to assist in the development of space systems and support operations of terrestrial assets. These systems include expendable launch vehicles, satellites, space-based experiments, and components and payloads associated with the International Space Station. The Company also supports Northrop Grumman in development of sophisticated airborne electronic sensors and systems.

On May 29, 2002, the Company announced that it had been awarded a \$164 million Expendable Launch Vehicle Integrated Support (ELVIS) prime contract by NASA. The ELVIS contract was effective July 1, 2002 and has a nine-year and four-month period of performance including all options. Under the ELVIS contract, Analex will provide a broad range of expendable launch vehicle support services for NASA requirements at John F. Kennedy Space Center, Florida; Cape Canaveral Air Force Station, Florida; Vandenberg Air Force Base, California; and other locations. Under the contract, Analex is responsible for engineering services, performing safety and mission assurance functions, and providing communications, computing and telemetry support.

Under the ELVIS contract, the Company is the prime contractor with three subcontractors performing various functions. Approximately 27% of the contract is expected to be performed by the subcontractors. As the prime contractor, the Company is responsible for all aspects of work performed by the subcontractors including, but not limited to, quality of work, timeliness of performance, and cost control. The Company records all customer payments under this contract as revenues and all subcontractor invoices as contract costs.

The Systems Engineering Group provides a broad range of aerospace engineering services to support the programs of NASA Glenn Research Center in Cleveland, Ohio. These support services include development of next generation launch vehicles, engineering design and development of aerospace systems, engineering support to research and technology development, engineering support to operations of experimental systems, and project management support.

Under the Company's Microgravity Research Development and Operations Contract, Systems Engineering also supports NASA Glenn Research Center in development of an automated laboratory environment to be installed aboard the International Space Station to enable research in the performance of fluids and combustion in the near-zero gravity of space. The Company participates in the design, development, manufacturing, test and delivery of the fluids and combustion facility and associated subsystems.

### ***Advanced Biosystems Segment***

The Company's role in bio-defense began in 1999 when it established its Advanced Biosystems subsidiary. Since then, an elite group of biologists, immunologists and other researchers have conducted research to develop effective medical defenses and treatments for anthrax, smallpox and other biological warfare agents.

ABS scientists advise Congress, members of the Bush administration, Department of Defense officials and senior members of the medical community on strategies for bio-defense. ABS also provides training on biological warfare agents, their effects, and defensive strategies to improve preparedness. ABS has been awarded almost \$12 million in contracts with the Defense Advanced Research Projects Agency ("DARPA") for

development of non specific-immunity based defenses against biological threat agents. ABS was awarded a grant from the National Institutes of Health (NIH) to study the role of certain cellular components in blocking the development of Anthrax. In total, ABS has received to date more than \$17 million in research grants.

In December 2002, ABS entered into a Memorandum of Understanding with George Mason University regarding collaborative efforts on certain projects and the use of George Mason laboratory facilities. ABS' Chief Scientist, Dr. Ken Alibek, also serves as Executive Director of the George Mason Center for Biodefense and a member of the George Mason faculty.

ABS engages in an on-going process of biomedical research. ABS' primary activities to date have involved testing novel applications of scientific theories in the areas of immunology (the study of immune systems) and the pathogenesis of toxic agents in order to develop broad-based, rapid acting defenses against these toxic agents. ABS has not yet developed new marketable technologies or products based on its research. ABS has filed patent applications with respect to novel scientific and research insights into pathogenic processes and the effects of experimental agents in interrupting toxic pathways, but none of these patent applications have been reviewed by the Patent and Trademark Office.

Parties such as ABS that are interested in performing federally-funded research apply for available research grants and are selected on the basis of expertise, past research activity and research plans. The grants mandate that contract researchers submit regular reports on the progress of their research. Award grantees submit invoices and are paid on a regular basis, usually monthly, for their actual costs incurred in performing research, up to the total amount of the grant. As with any government contract, these research grants are terminable at the convenience of the government at any time. Moreover, it is possible that Congress or the government agencies that administer government research programs will decide to scale back programs or terminate them. In certain cases with respect to on-going programs of research, there are opportunities to receive additional grants upon the achievement of stated research objectives.

Under the Defense Federal Acquisition Regulations and the Federal Acquisition Regulation, ABS owns any intellectual property developed under its DARPA and NIH contracts, respectively, subject to a non-exclusive, royalty free license to the U.S. Government. Although ABS has not yet developed technologies or products that would be subject to federal regulations, any technologies or products which ABS may develop may be subject to the regulatory processes of the Federal Drug Administration or other governmental agencies.

### **Government Procurement and Significant Customers**

The principal customer for the Company's services is the U.S. government. The Company's sales to the U.S. government and its prime contractors represented approximately 98% of total net sales during the Company's twelve months ended December 31, 2002, 2001, the six month periods ended December 31, 2000 and 1999, and the fiscal year 2000, and are expected to continue to account for a substantial portion of the Company's revenues for the foreseeable future.

The principal U.S. government customer is the Department of Defense, which, directly or through its prime contractors, accounted for approximately 52%, 64%, 70%, 76%, and 92% of the Company's revenues in the twelve months ended December 31, 2002, 2001, the six month periods ended December 31, 2000 and 1999, and the fiscal year 2000, respectively. With the acquisition of the former Analex Corporation in November 2001, NASA became a significant customer, generating 45% and 11% of revenues for the twelve months ended December 31, 2002 and 2001.

During 2002, the Company derived revenues from subcontracts with Northrop Grumman and QSS Group, Inc., which in the aggregate comprised 24% and 15%, respectively, of the Company's total revenues for the year. Approximately 42% of the Company's revenues were generated as a prime contractor to the federal government and approximately 56% of the Company's revenues were generated as a subcontractor to a prime contractor to the federal government during the year ended December 31, 2002.

The Company's contracts with the U.S. government are subject to the availability of funds through annual appropriations, may be terminated by the government for its convenience at any time, and generally do not require the purchase of a fixed quantity of services or products. Reductions in U.S. government defense spending could adversely affect the Company's operating results. While the Company is not aware of present or anticipated reductions in U.S. government spending on specific programs or contracts, there can be no assurance that such reductions will not occur or that decreases in U.S. government defense spending in general will not have an adverse effect on the Company's revenues in the future. Contracts with the U.S. government are subject to audit by the Defense Contract Audit Agency.

The Company has been a contractor or subcontractor with the Department of Defense continuously since 1973 with periodic renewals. During this time, neither the Company nor its subsidiaries have experienced any material adjustment of profits under its contracts. However, no assurance can be given that the Department of Defense will not seek and obtain an adjustment of profits in the future. All U.S. government contracts contain clauses that allow for the termination of contracts at the convenience of the U.S. government.

The preponderance of the Company's technical and professional services business with the Department of Defense and other governmental agencies is obtained through competitive procurement and through follow-on services related to existing business. In certain instances, however, the Company acquires such service contracts because of special professional competency or proprietary knowledge in specific subject areas.

### **Government Contracts**

Direct and indirect contracts with government defense and intelligence agencies comprise the majority of the Company's business base, and competition for government-funded projects continues to exert pressure on profit margins. During 2002, 59% of the Company's contracts were cost-reimbursement, 34% were time-and-materials, and 7% were firm fixed-price. Following are brief descriptions of the various types of contracts the Company receives from the government.

Cost-reimbursement contracts provide for payment of allowable incurred costs, to the extent prescribed in the contract, plus a profit component. These contracts establish an estimate of total cost for the purpose of obligating funds and establishing a ceiling that the contractor may not exceed without the approval of the contracting officer. Cost-reimbursement contracts are suitable for use when uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use a fixed-price contract. Cost-reimbursement contracts covered by the Federal Acquisition Regulation require an audit of actual costs and provide for upward or downward adjustments if actual recoverable costs differ from billed recoverable costs.

Time-and-materials (T&M) contracts provide for acquiring services on the basis of direct labor hours at specified fixed hourly rates. A T&M contract may also provide for acquiring materials, including, if appropriate, material handling costs. Profit margins on T&M contracts fluctuate based on the difference between negotiated billing rates and actual labor and overhead costs directly charged or allocated to such contracts.

Firm fixed-price contracts provide for delivery of products or services for a price that is negotiated in advance on the basis of the contractor's cost experience. The price is not subject to any adjustment unless there is a change in the scope of work. Profit margins increase to the extent that costs are below the contracted amounts. If the costs exceed the estimates, profit margins decrease and a loss may be realized on the contract.

### **Contract Backlog**

The Company's backlog of orders believed to be firm as of December 31, 2002 was approximately \$169 million, of which approximately \$166 million was attributable to the Analex segment and \$3 million was attributable to the ABS segment. The portion of the total backlog expected to be realized within 2003 is \$35 million. Included in the backlog approximation are amounts from future years of government contracts under which the government has the right to exercise an option for the Company to perform services.

## **Competition**

In general, the industry in which the Company operates includes a large number of competitors of varying sizes. Competition within the information technology and government contracting arenas is intense. The Company maintains a primary commitment to its current direct and indirect government clients, while intensifying its business development efforts to win additional government clients. The Company is continuing efforts to diversify its client base.

The Analex segment generally competes against federal systems integrators such as Anteon International Corporation, CACI International Inc., Computer Sciences Corporation, Science Applications International Corporation, Veridian Corporation, among others including a variety of small, privately-held government contractors offering information technology and systems engineering services to the U.S. government. In addition, the Systems Engineering Group competes against large aerospace contractors such as Boeing and Lockheed Martin and other small privately held firms in the provision of launch related services. Selection is based primarily on a combination of the price of services and evaluation of technical capability, as well as past performance, quality of service and responsiveness to client requirements.

Within the Analex segment, the Company believes that the Homeland Security Group has a competitive advantage in its skilled engineers and customer relationships within the intelligence community and in its expertise and experience with independent verification and validation of space launch vehicles. However, larger government contractors can provide a breadth of professional offerings that the smaller Homeland Security Group may not be able to match. The Company also believes that the Systems Engineering Group has a competitive advantage in space launch support, especially in the expendable launch vehicle support segment, arising from the Company's work on the ELVIS contract. Given the Company's size, larger government contractors operating in this business area may be able to provide a breadth of service offerings beyond the Company's capabilities.

The ABS segment's main competition comes from individual research professionals and research groups at academic institutions seeking government funded research work. ABS competes for research grants on the basis of scientific expertise, past research activity and past performance under previous research grants. In the event that any technologies or products are developed based on ABS' research, ABS will likely compete against a variety of large and small biotechnology and pharmaceutical businesses.

ABS' competitive advantage is the past experience of its Chief Scientist in developing bio-warfare strategies and weapons for the former Soviet Union. ABS' small size and dependence upon government grants to fund on-going medical research is a disadvantage in comparison to other biotechnology firms that may be involved in similar research.

## **Employees**

As of December 31, 2002, the Company (including its subsidiaries) employed approximately 534 people. Of the 534 employees, 44 are members of unions, and employee relations are believed by management to be generally good. In October 2002, the Company entered into a three-year Collective Bargaining Agreement with the International Brotherhood of Teamsters representing approximately 32 employees on the NASA ELVIS contract at Vandenberg Air Force Base in California. In February 2003, the Company entered into a three-year Collective Bargaining Agreement with the International Brotherhood of Electrical Workers representing approximately 12 employees on the NASA ELVIS contract at the Kennedy Space Center in Florida.

## **General Information**

Raw materials, patents, licenses, trademarks, franchises and concessions are not materially important to the conduct of the Company's business and the Company's business is not seasonal. The Company derives no revenues from foreign operations.

**Recent Developments**

On March 4, 2003, Analex began trading on the American Stock Exchange "Amex" under the symbol NLX.

**Change in Fiscal Year**

On February 14, 2001, the Board of Directors of the Company approved a change of the Company's fiscal year from the period of July 1 through June 30 to the period of January 1 through December 31, and declared the period of July 1, 2000 through December 31, 2000 the transition period.

**Available Information**

The Company files annual, quarterly and special reports, proxy statements and other information with the Securities and Exchange Commission ("SEC"). The public may read and copy any materials the Company files with the SEC at the SEC's Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site at <http://www.sec.gov> that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC, including the Company. The Company also provides a link to certain of its most recent filings with the SEC at the Company's Internet site at <http://www.analex.com>. The information contained on the Company's Internet site is not part of this Annual Report.

**Item 2. Properties**

The Company owns no real property. As of December 31, 2002, the Company leased a total of 68,373 square feet of office space at various locations in Virginia, Maryland, Colorado and Ohio. These leases expire between February 2002 and September 2006. (See Note 12 of the Notes to Consolidated Financial Statements.)

**Item 3. Legal Proceedings**

No material legal proceedings are currently pending.

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

None.

## PART II

### Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

Prior to March 3, 2003, the Company's common stock was traded over the counter (OTC) and quoted on the OTC Bulletin Board under the symbol "ANLX". On March 4, 2003, the common stock was listed on the American Stock Exchange and began trading under the symbol "NLX".

The range of high and low bid quotations for the Common Stock, as reported by the OTC Bulletin Board, for each quarterly period during 2002, 2001, the six-month period ended December 31, 2000 and fiscal year 2000 is shown below. The prices presented below reflect inter-dealer prices without retail mark-ups, mark-downs or commissions, and may not reflect actual transactions.

| <u>Year Ended December 31, 2002</u>        | <u>High</u>     | <u>Low</u>     |
|--|-----------------|----------------|
| First Quarter<br>(1/1 to 3/31/02) .....    | 2.45            | 1.60           |
| Second Quarter<br>(4/1 to 06/30/02) .....  | 2.85            | 1.73           |
| Third Quarter<br>(7/1 to 09/30/02) .....   | 2.88            | 2.09           |
| Fourth Quarter<br>(10/1 to 12/31/02) ..... | 2.65            | 2.30           |
| <br><u>Year Ended December 31, 2001</u>    | <br><u>High</u> | <br><u>Low</u> |
| First Quarter<br>(1/1 to 3/31/01) .....    | 1.44            | .81            |
| Second Quarter<br>(4/1 to 06/30/01) .....  | 1.40            | 1.00           |
| Third Quarter<br>(7/1 to 09/30/01) .....   | 2.50            | 1.06           |
| Fourth Quarter<br>(10/1 to 12/31/01) ..... | 4.55            | 1.40           |
| <br><u>Period Ended December 31, 2000</u>  | <br><u>High</u> | <br><u>Low</u> |
| First Quarter<br>(7/1 to 9/30/00) .....    | 1.06            | .63            |
| Second Quarter<br>(10/1 to 12/31/00) ..... | 1.56            | .75            |
| <br><u>Fiscal Year Ended June 30, 2000</u> | <br><u>High</u> | <br><u>Low</u> |
| First Quarter<br>(7/1 to 9/30/99) .....    | 1.28            | .63            |
| Second Quarter<br>(10/1 to 12/31/99) ..... | .75             | .50            |
| Third Quarter<br>(1/1 to 3/31/00) .....    | 2.00            | .47            |
| Fourth Quarter<br>(4/1 to 6/30/00) .....   | 1.56            | .75            |



As of November 5, 2003, there were approximately 2,175 shareholders of record of the Company's Common Stock. No cash dividends were paid during 2002 or during the past three fiscal years, and no dividends are expected to be declared during 2003. The ability of the Company to pay dividends on its Common Stock requires the consent of Bank of America, N.A. under the Company's credit agreement with Bank of America.

The Company does not have any equity compensation program that was not approved by stockholders. Set forth below is certain information as of December 31, 2002, regarding equity compensation plans that have been approved by stockholders.

| <u>Equity<br/>compensation plans<br/>approved by<br/>stockholders</u> | <u>Number of<br/>securities to be<br/>issued upon<br/>exercise of<br/>outstanding<br/>options and rights</u> | <u>Weighted average<br/>exercise price</u> | <u>Number of<br/>securities<br/>remaining<br/>available for<br/>issuance under the<br/>plan(s)</u> |
|---|--|--|--|
| Stock Option Plans .....  | 2,456,100  | \$1.55                                     | 666,900  |

#### Item 6. Selected Financial Data

The following selected consolidated financial data as of December 31, 2002 and 2001, for the six months ended December 31, 2000 and 1999 and for the fiscal years ended June 30, 2000, 1999 and 1998 have been taken from the consolidated financial statements of the Company. This data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations," and the consolidated financial statements and the related notes thereto included elsewhere in this Report.

|   | <u>Year<br/>Ended<br/>12/31/02</u>                  | <u>Year<br/>Ended<br/>12/31/01</u> | <u>Six<br/>Months<br/>Ended<br/>12/31/00</u> | <u>Unaudited<br/>Six<br/>Months<br/>Ended<br/>12/31/99</u> | <u>Fiscal<br/>Year<br/>6/30/00</u> | <u>Fiscal<br/>Year<br/>6/30/99</u> | <u>Fiscal<br/>Year<br/>6/30/98</u> |
|---|---|------------------------------------|--|--|------------------------------------|------------------------------------|------------------------------------|
|   | (In thousands of dollars, except per share amounts) |                                    |  |  |                                    |                                    |                                    |
| Total Revenues(1) .....                           | \$59,317  | \$21,936                           | \$8,943                                      | \$10,267   | \$19,901                           | \$20,333                           | \$21,134                           |
| Operating Income (Loss) .....                     | 3,524   | 432                                | 190  | (481)  | (421)                              | 63                                 | 888                                |
| Interest Expense, net of Interest<br>income ..... | 1,018   | 217                                | 112  | 167  | 324                                | 78                                 | 56                                 |
| Income (Loss) Before income taxes                 | 2,506   | 216                                | 85   | (631)  | (724)                              | 48                                 | 819                                |
| Net Income (Loss)(1) .....                        | 2,357   | 196                                | 85   | (631)  | (745)                              | 34                                 | 761                                |
| Income (Loss) per share                           |   |                                    |  |  |                                    |                                    |                                    |
| Basic .....                                       | .16   | .03                                | .01  | (.24)  | (.23)                              | .02                                | .45                                |
| Diluted .....                                     | .14   | .02                                | .01  | (.24)  | (.23)                              | .01                                | .26                                |
| At Period End:                                    |   |                                    |  |  |                                    |                                    |                                    |
| Total Assets .....                                | 30,784  | 25,625                             | 5,784  | 6,127  | 5,951                              | 6,690                              | 3,507                              |
| Long-term Liabilities .....                       | 4,430   | 5,064                              | 412  | 1,040  | 702                                | 2,160                              | 53                                 |
| Working Capital (Deficit) .....                   | 676   | (702)                              | 266  | (1,454)  | (13)                               | (67)                               | (186)                              |
| Shareholders' Equity (Deficit) .....              | 13,902  | 11,175                             | 2,002  | (80)   | 1,535                              | 456                                | 22                                 |

(1) See Item 7 "Management's Discussion and Analysis" for an explanation of events that materially affect comparability.

## **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **Forward-Looking Statements**

The statements contained in this report that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including without limitation, statements about the Company's expectations, beliefs, intentions or strategies regarding the future. All forward-looking statements included in this report are based on information available to the Company on the date hereof, and the Company assumes no obligation to update any such forward-looking statements. The forward-looking statements contained herein involve risks and uncertainties. The Company's actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth in this report.

### **Critical Accounting Policies**

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States, which require the Company to make estimates and assumptions. The Company's significant accounting policies are described in Note 2 to the consolidated financial statements. The Company believes that the following critical accounting policies require significant management judgments, estimates and assumptions in the preparation of the consolidated financial statements.

#### *Revenue*

The Company's contracts with the government are typically cost plus fee, time and materials, or fixed-price contracts. Revenues result from work performed on these contracts by the Company's employees and from pass-through of costs for material and work performed by subcontractors. Revenues on cost-type contracts are recorded as contract-allowable costs are incurred and fees earned. Revenues for time and materials contracts are recorded on the basis of contract-allowable labor hours worked multiplied by the contract defined billing rates, plus the cost of materials used in performance on the contract. Profits on time and material contracts result from the difference between the cost of services performed and the contract defined billing rates for these services. Revenue on certain fixed-price service contracts are recorded each period based on a monthly amount for services provided. Revenues on other fixed-price contracts are recorded as costs are incurred, using the percentage-of-completion method of accounting. Profits on fixed-price contracts result from the difference between the incurred costs and the revenue earned. In the normal course of business, the Company may be party to claims and disputes resulting from modifications and change orders and other contract matters. Claims for additional contract compensation are recognized when realization is probable and estimable.

#### *Long-Lived Assets*

In assessing the recoverability of long-lived assets, including goodwill and other intangibles, the Company must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets. If these estimates or the Company's related assumptions change in the future, the Company may be required to record impairment charges for these assets not previously recorded.

#### *Contingencies*

From time to time, the Company is subject to proceedings, lawsuits and other claims related to labor and other matters. The Company is required to assess the likelihood of any adverse judgments or outcomes to these contingencies as well as potential ranges of probable losses and establish reserves accordingly. The amount of reserves required, if any, may change in future periods due to new developments in each matter or changes in approach to a matter such as a change in settlement strategy.

### *Derivatives*

The Company utilizes an interest rate swap to manage interest rate exposure. The interest rate swap has been designated as a cash flow hedge, wherein the effective portion of the change in value of the derivative instrument, based on market pricing, is reported as a component of other comprehensive income (loss) and is reclassified into earnings as interest expense in the period when the hedged transaction affects earnings. The ineffective portion of the change in value of the derivative instrument, if any, is recognized in current earnings during the period of change. The interest rate swap is carried at fair value in other liabilities.

### Results of Operations Comparison Of Year Ended December 31, 2002 To the Year Ended December 31, 2001

Revenues for the year ended December 31, 2002 were approximately \$59.3 million, a 170% increase from the \$21.9 million in revenues for the year ended December 31, 2001. This increase is primarily due to revenues of approximately \$27.0 million attributable to the business acquired from the former Analex Corporation in November 2001, coupled with revenues of approximately \$9.0 million generated by the NASA ELVIS contract that began July 1, 2002. In addition, approximately \$2.0 million of additional revenues were generated by ABS due to an increase in research under National Institutes of Health grants that were awarded in mid-2001 and early 2002. Increases or decreases in revenue are predominantly attributable to changes in the volume of services provided. As a government contractor, costs billed to the government are prescribed by Federal Acquisition Regulations and include recovery of allowable costs such as labor, fringe benefits, overhead and general and administrative expenses plus a reasonable fee.

Costs of revenue for the year ended December 31, 2002 were approximately \$50.4 million, an increase of approximately 180% from the prior year. The increase is primarily due to the costs of revenue from the business acquired from the former Analex Corporation, which were approximately \$23.0 million, coupled with costs associated with the ELVIS contract which were approximately \$8.0 million. In addition, approximately \$1.0 million of additional costs were attributable to the increased research efforts at ABS. Costs of revenue as a percentage of revenues were approximately 85% for the year ended December 31, 2002 and 83% for the year ended December 31, 2001.

Selling, general and administrative expenses totaled approximately \$5.0 million, 8.5% of revenues, for the year ended December 31, 2002, compared with approximately \$3.0 million, 13.5% of revenues, for the year ended December 31, 2001. The \$2.0 million, or 70% increase is primarily due to the addition of the former Analex Corporation's costs associated with additional corporate and management staff required by the increased size of the Company. In addition, 2002 included the bid and proposal costs associated with winning the ELVIS contract, which were approximately \$0.2 million. However, the increase in the Company's revenues reduced selling, general and administrative expenses as a percentage of revenues, allowing the Company to increase spending on such items as new business development while improving operating profit margins.

The Company had operating income of approximately \$3.5 million for the year ended December 31, 2002, compared to operating income of approximately \$0.4 million for the year ended December 31, 2001. This \$3.1 million increase is primarily attributable to the profitability of the business acquired from the former Analex Corporation, which contributed approximately \$2.0 million along with profits generated by the ELVIS contract, which approximated \$0.3 million. In addition, ABS operating income increased by approximately \$0.2 million from 2001 to 2002, due to factors mentioned above.

The Company had interest expense of \$1.0 million for the year ended December 31, 2002, compared to interest expense of \$0.2 million for the year ended December 31, 2001. The increase is primarily due to \$0.8 million of interest on debt related to the acquisition of Analex Corporation, partially offset by a reduction in interest rates.

The Company had amortization expense of \$0.3 million for the year ended December 31, 2002, compared to amortization expense of \$0.4 million for the year ended December 31, 2001. The decrease in amortization

expense is due to the adoption of SFAS 142, which ceased amortization of the goodwill resulting from a 1999 acquisition, which was offset by a full year of amortization of certain intangible assets related to the acquisition of Analex Corporation.

Income tax expense for the year ended December 31, 2002 was \$0.1 million compared with \$0.02 million in the prior year. The Company's effective tax rate did not change significantly from 2001 to 2002. In both years, the Company's provision for income taxes was limited to state taxes and alternative minimum tax as the Company has been able to utilize its net operating loss carryforwards to offset taxable income.

Results of Operations  
Comparison Of Year Ended December 31, 2001 To  
the Unaudited Twelve Months Ended December 31, 2000

Revenues for the twelve months ended December 31, 2001 were approximately \$21.9 million, an 18% increase from the \$18.6 million in revenues for the twelve-month period ended December 31, 2000. This increase is primarily due to the addition of two months of revenues, totaling \$4.7 million, generated by the business acquired from the former Analex Corporation in November 2001, coupled with the increased ABS revenues of approximately \$2.4 million attributable to a newly awarded contract with the Department of the Army. Revenues decreased by approximately \$4.0 million in the Homeland Security Group due to a shift of business from the Homeland Security Group to its client, Johns Hopkins University's Applied Physics Laboratory, of approximately \$3.0 million. Increases or decreases in revenue are predominantly attributable to changes in the volume of services provided. As a government contractor, costs billed to the government are prescribed by Federal Acquisition Regulations and include recovery of allowable costs such as labor, fringe benefits, overhead and general and administrative expenses plus a reasonable fee.

Costs of revenue for the twelve months ended December 31, 2001 were approximately \$18.2 million, an increase of approximately 18% from the same period in the prior year. The increase is primarily due to the costs of revenue from the business acquired from the former Analex Corporation, which were approximately \$4.3 million, coupled with increased ABS costs of approximately \$2.3 million from growth due to the award of the contract with the Department of the Army, partially offset by decreased costs of the Homeland Security Group of approximately \$3.8 million due to factors noted above. Costs of revenue as a percentage of revenues were approximately 83% for the twelve months ended December 31, 2001 and 2000.

Selling, general and administrative expenses totaled approximately \$3.0 million for the twelve months ended December 31, 2001, compared with approximately \$2.6 million for the twelve months ended December 31, 2000. The \$0.4 million, or 15% increase is primarily due to the addition of staff and support costs of the former Analex Corporation. In addition, two key senior management positions and one business development position were filled throughout 2001.

The Company had amortization expense of \$0.4 million for the twelve months ended December 31, 2001, compared to \$0.3 million for the twelve months ended December 31, 2000. This increase is due to amortization of certain intangible assets related to the acquisition of Analex Corporation totaling \$0.04 million.

The Company had operating income of approximately \$0.4 million for the twelve months ended December 31, 2001, compared to operating income of approximately \$0.3 million for the twelve month period ended December 31, 2000. This \$0.1 million increase is primarily attributable to the profitability of contracts of the former Analex Corporation of approximately \$0.4 million, partially offset by the Company's acquisition costs.

Income tax expense for the twelve months ended December 31, 2001 and 2000 was \$0.02 million. The Company's effective tax rate did not change significantly from 2000 to 2001. In both years, the Company's provision for income taxes was limited to state taxes and alternative minimum tax as the Company has been able to utilize its net operating loss carryforwards to offset taxable income.

Results of Operations  
Comparison Of Six Month Period Ended December 31, 2000  
To the Unaudited Six Month Period Ended December 31, 1999

Revenues for the six months ended December 31, 2000 were approximately \$8.9 million, a 13% decrease from the \$10.3 million in revenue for the period ended December 31, 1999. This decrease is primarily due to a shift in business from the Homeland Security Group to its client, Johns Hopkins University's Applied Physics Laboratory, of \$2.7 million, partially offset by additional revenue produced by ABS of approximately \$1.9 million from a newly awarded contract with the Defense Advanced Research Projects Agency. The Company's billable staff dedicated to the Applied Physics Laboratory contracts decreased 83% between December 31, 1999 and December 31, 2000. Increases or decreases in revenue are predominantly attributable to changes in the volume of services provided. As a government contractor, costs billed to the government are prescribed by Federal Acquisition Regulations and include recovery of allowable costs such as labor, fringe benefits, overhead and general and administrative expenses plus a reasonable fee.

Costs of revenue for the six months ended December 31, 2000 were approximately \$7.6 million, a decrease of approximately 13% from the same period in the prior year. The decrease is primarily due to the lower costs of the Homeland Security Group due to the shift in business to Applied Physics Laboratory of \$2.6 million offset by costs associated with the increased ABS revenues of approximately \$1.8 million due to growth. Costs of revenue as a percentage of revenues were approximately 85% for the six-month periods ended December 31, 2000 and 1999, respectively.

Selling, general and administrative expenses totaled approximately \$1.0 million for the six months ended December 31, 2000, compared with approximately \$1.8 million for the same period of the prior year. The \$0.8 million, or 46%, decrease is primarily due to the Company's aggressive cost reduction and containment program including reducing administrative staff and discretionary expenses.

The Company had operating income of \$0.2 million for the six months ended December 31, 2000, compared to an operating loss of \$0.5 million for the period ended December 31, 1999. This \$0.7 million increase is primarily attributable to the Company's aggressive cost reductions noted above coupled with increases in research under the ABS contracts noted above.

Income tax expense for the six months ended December 31, 2000 and the six months ended December 31, 1999 was zero. For the six months ended December 31, 1999, the Company incurred an operating loss and therefore, was not subject to any income tax. For the six months ended December 31, 2000, the Company was able to utilize net operating loss carryforwards to offset taxable income.

### **Capital Resources and Liquidity**

The working capital at December 31, 2002 increased by approximately \$1,377,300 from December 31, 2001, primarily due to increased profitability generated by the Company's purchase of the former Analex Corporation and the award of the ELVIS contract.

In the twelve months ended December 31, 2002, the Company recorded net income of \$2,356,600 and EBITDA of \$3,943,000, after add-backs for interest of \$1,018,300, taxes of \$149,100, depreciation of \$111,400 and amortization of \$307,600.

The Company believes that cash provided by operations will be sufficient to fund working capital needs for the next twelve months.

EBITDA consists of earnings before interest expense, interest and other income, income taxes, depreciation and amortization. EBITDA does not represent funds available for the Company's discretionary use and is not intended to represent cash flow from operations. EBITDA should also not be construed as a substitute for operating income or a better measure of liquidity than cash flow from operating activities, which are determined

in accordance with accounting principles generally accepted in the U.S. EBITDA excludes components that are significant in understanding and assessing the Company's results of operations and cash flows. EBITDA is considered to be relevant and useful information, which is often reported and widely used by analysts, investors and other interested parties. Accordingly, the Company is disclosing this information to permit a more comprehensive analysis of the Company's operating performance, as an additional meaningful measure of performance and liquidity, and to provide additional information with respect to the Company's ability to meet future debt service, capital expenditure and working capital requirements.

Net cash provided by operating activities was \$1,299,500 during the twelve months ended December 31, 2002, compared to a net use of cash from operating activities of \$435,400 for the prior year. The increased net cash provided by operating activities resulted primarily from increased net income in 2002 compared to 2001.

Net cash used in investing activities during the twelve months ended December 31, 2002 was \$240,000. Net cash used in investing activities in this period was for fixed asset purchases and legal fees associated with the filing of patent applications for ABS.

Net cash used by financing activities in 2002 amounted to \$840,800 compared to net cash provided by financing activities in 2001 of \$6,537,500. In 2002 the Company paid down net bank debt of \$1,000,500 compared to net bank borrowings of \$2,335,400 and net proceeds from the issuance of common stock of \$3,917,600 in 2001 associated with the acquisition of the former Analex Corporation. For 2002, the Company generated a net increase in cash and equivalents of \$218,700 compared to a net decrease of \$151,800 in 2001.

Effective November 2001, the Company acquired Analex, a professional services and program management firm whose principal customers are NASA and the U.S. intelligence community, for approximately \$13,898,000. The purchase price was satisfied with cash payments of \$6,510,000, 3,520,339 shares of Common Stock valued at \$4,664,000, the issuance of promissory notes of \$1,773,000, non-compete arrangements for which consideration was \$892,000, and the satisfaction of other certain liabilities of Analex.

The fair value of the assets acquired and liabilities assumed approximated their book value of \$6,092,400 and \$5,730,000, respectively. The Company incurred financial, legal and accounting costs associated with the Analex purchase of approximately \$570,000. During 2002, certain contingencies were finalized including the settlement of the Analex closing balance sheet requirements and the award of the ELVIS contract.

The acquired Analex brought new skill sets to the combined company, including specialized expertise providing test analysis and independent validation and verification support. These services are provided to the United States Air Force and the National Reconnaissance Office. The acquisition has provided a platform for the Company to bid on several new contracts in areas utilizing Analex's skill sets.

In addition, the acquired Analex has a significant presence at NASA, a new customer for the Company at the time of the acquisition. At NASA, the acquired Analex provided a broad scope of aerospace engineering services supporting Glenn Research Center on various contracts. The acquired Analex has won numerous awards for the design, development, analysis, and testing of products and systems for the aerospace, information technology, high-tech manufacturing, telecommunications, and medical industries. The acquired Analex had more than 300 employees, bringing the number of employees of the consolidated company to 450. The acquisition resulted in a 125% increase in the Company's revenue base.

On November 2, 2001, to finance the acquisition of Analex, the Company entered into a Credit Agreement with Bank of America, which provides the Company with a \$4,000,000 Revolving Credit Facility through November 2, 2006 and a five-year \$3,500,000 Term Loan. The Revolving Credit Facility has an annual renewal

occurring April 30 of each year. The principal amount of the Term Loan is amortized in sixty equal monthly payments of \$58,333. In August 2002, the credit limit on the Revolving Credit Facility was increased to \$8,000,000. At December 31, 2002, the outstanding balance on the Revolving Credit Facility was \$2.2 million and the outstanding balance on the Term Loan was \$2.7 million.

Interest on each of the facilities is at the LIBOR Rate plus an applicable margin as specified in a pricing grid. The Company is subject to certain financial covenants pursuant to the Agreement, including debt to EBITDA ratio, fixed charge coverage ratio, senior debt to EBITDA ratio, and net worth requirements. The Company must maintain the following ratios: a Total Funded Debt to EBITDA ratio of no greater than 3.0 to 1.0, a Senior Debt to EBITDA ratio of no greater than 2.75 to 1.0, a Fixed Charge Coverage Ratio of no less than 1.3 to 1.0, and Net Worth equal to at least the sum of \$9 million and 65% of net income (not to be reduced by net losses) during each fiscal quarter ending March 31, 2002 and thereafter. At December 31, 2002, the Company was in compliance with each of these covenants. The Credit Facility and Term Loan are secured by the accounts receivable and other assets of the Company. The Company was required by Bank of America to obtain personal guarantees in the amount of \$2,000,000, which the Company procured from two individuals, the Company's Board member Gerald R. McNichols and the Company's Investment Banker J. Richard Knop. The compensation during the period of guaranty is in the form of cash and warrants. On December 20, 2002, Mr. McNichols and Mr. Knop were released from their guarantees.

In October 2001, the Company issued 3,961,060 shares of Common Stock for aggregate consideration of approximately \$3,868,000 through a private placement pursuant to Regulation D under the Securities Act of 1933 consisting of (i) the Company's Common Stock at a price of \$1.14 per share to purchasers who purchased less than \$500,000 worth thereof or (ii) units consisting of the Company's Common Stock and warrants to purchase 0.2061 shares of the Company's Common Stock at an exercise price of \$0.02 per share for each share purchased at a price of \$1.14 per unit for purchasers who purchased \$500,000 or more of the Company's equity. Two of such purchasers are directors or affiliates of a director. All of these proceeds were directed to financing the acquisition of Analex.

On November 2, 2001, the Company issued promissory notes to certain Analex sellers totaling \$773,000 with a five-year term, bearing interest at 6%. At December 31, 2002, the outstanding balance on the promissory notes was \$635,900. The Company also entered into non-competition agreements with these Sellers for total payments of \$540,000 over a three-year period. In addition, the Company entered into non-competition agreements with former employees totaling \$352,000, on a discounted basis, payable over various periods. At December 31, 2002, the outstanding balance on the non-competition agreements was \$540,000.

With its purchase of Analex, the Company assumed a note payable to the Department of Justice ("DOJ"). The agreement provides for quarterly payments of \$80,000 consisting of principal and interest at 7% through February 2006, with a final payment due in May 2006. At December 31, 2002, the outstanding balance on the DOJ note payable was \$946,400. As part of the Analex acquisition, the Company assumed a liability to the Department of Justice. This liability arose as a settlement between the former Analex Corporation and the Department of Justice in 1994 due to false claims made by the former Analex Corporation to the U.S. government during the years 1982 through 1986.

On May 29, 2002, Analex announced that it had been awarded a \$164 million Expendable Launch Vehicle Integrated Support ("ELVIS") prime contract by NASA. In conjunction with this award the Company issued promissory notes to certain Analex sellers totaling \$1,000,000 with a three-year term, bearing interest at prime plus 1%. At December 31, 2002, the outstanding balance on these notes was \$916,700.

### Contractual Obligations

The Company has contractual obligations to pay long-term debt, leases and other non-cancelable obligations. The following table aggregates the amounts of these obligations as of December 31, 2002:

| Year                                | Long-term<br>debt(1) | Operating<br>Leases | Non-compete<br>Agreements | Total              |
|-------------------------------------|----------------------|---------------------|---------------------------|--------------------|
| 2004 .....                          | \$1,468,900          | \$1,037,600         | \$261,900                 | \$2,768,400        |
| 2005 .....                          | 1,412,700            | 774,200             | 242,700                   | 2,429,600          |
| 2006 .....                          | 922,500              | 56,200              | 16,400                    | 995,100            |
| 2007 .....                          |                      |                     | 13,700                    | 13,700             |
| Total contractual obligations ..... | <u>\$3,804,100</u>   | <u>\$1,868,000</u>  | <u>\$534,700</u>          | <u>\$6,206,800</u> |

(1) Does not include line of credit due to its short-term nature. The line of credit is subject to renewal each year. As of December 31, 2002, \$2.2 million was outstanding on the line of credit.

Payments for long-term debt do not include interest payments. Lease commitments could require higher payments than shown in the table due to escalation provisions that are tied to various measures of inflation. The lease commitments reflect only existing commitments and do not include future requirements necessary to replace existing leases. In addition to the contractual obligations included above, the Company also has routine purchase order commitments for materials and supplies that are entered into in the normal course of business and are not in excess of current requirements. Pursuant to the November 2, 2001 acquisition of Analex, the Company issued 3,572,143 shares of the Company's Common Stock to the shareholders representing all of the outstanding equity of Analex (the "Sellers"). Of the 3,572,143 shares, 857,143 shares are subject to a provision by which the Company guarantees for a five-year period to reimburse the Sellers the difference between the price at which they sell such shares and a guaranteed sales price ranging from \$1.60 to \$2.20 per share ("Guaranteed Shares"), if such shares are sold within such period and if certain other conditions are satisfied. As of December 31, 2002, the maximum amount that the Company would be required to pay under the terms of the guarantee was \$728,600. This amount is calculated by multiplying the number of shares subject to the guarantee by their associated guaranteed purchase price, assuming the Company's common stock has no fair market value. As of December 31, 2002, there were 214,286 shares with an associated purchase price guarantee of \$1.60 per share and 214,286 shares with an associated guaranteed purchase price of \$1.80 per share. As the fair market value of the Company's common stock was in excess of the guaranteed share prices as of December 31, 2002, no amounts were accrued under the guarantee.

### Recently Issued Accounting Standards

In August 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 143, "Accounting for Asset Retirement Obligations" ("SFAS No. 143"). SFAS No. 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 143 is effective for financial statements issued for fiscal years beginning after June 15, 2002. The Company does not anticipate that adoption of SFAS No. 143 will have a material impact, either positive or negative, on future results of operations or financial condition.

In September 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"). SFAS No. 144 addresses financial accounting and reporting for the impairment and disposal of long-lived assets, including intangible assets with finite lives. The effective date for the Company's implementation of SFAS No. 144 was January 1, 2002.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure—an amendment of SFAS No. 123." This statement amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim



financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company has chosen to continue to account for stock-based compensation using the intrinsic value method prescribed in APB Opinion No. 25 and related interpretations. Accordingly, compensation expense for stock options is measured as the excess, if any, of the fair market value of the Company's stock at the date of the grant over the exercise price of the related option. The Company has adopted the annual disclosure provisions of SFAS No. 148 in its financial reports for the year ended December 31, 2002 and will adopt the interim disclosure provisions for its financial reports for the quarter ending March 31, 2003.

### **PART III**

#### **Item 10. Directors and Executive Officers of the Registrant**

#### **Item 11. Executive Compensation**

#### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

#### **Item 13. Certain Relationships and Related Transactions**

The information required by Items 10, 11, 12 and 13 of Part III of Form 10-K have been omitted in reliance on General Instruction G(3) to Form 10-K and are incorporated herein by reference to the Company's definitive proxy statement with respect to its 2003 Annual Meeting of Stockholders filed with the SEC on April 18, 2003 pursuant to Regulation 14A promulgated under the Securities Exchange Act of 1934, as amended.

#### **Item 14. Controls and Procedures**

Within 90 days prior to the date of this report, the Company's disclosure controls and procedures were evaluated, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer. Such controls and procedures were deemed to be effective to ensure that information required to be disclosed by the Company is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. There were no significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their last evaluation.

## Item 7A. Quantitative and Qualitative Disclosure about Market Risk

### Market Risks and Hedging Activities

The Company's outstanding bank debt bears interest at variable interest rates tied to LIBOR. The use of variable-rate debt to finance operations and capital improvements exposes the Company to variability in interest payments due to changes in interest rates. The Company uses an interest rate swap to reduce the interest rate exposure on these variable rate obligations. The Company does not hold any derivatives for trading or speculative purposes.

The Company's \$3.5 million term loan facility from Bank of America carries interest comprised of two components: floating-rate LIBOR plus a credit performance margin. The Company has entered into an interest—rate swap agreement with Bank of America whereby its obligation to pay floating-rate LIBOR is swapped into a fixed rate obligation at 4.25% beginning in January 2002. The Company continues to have the obligation to pay the credit performance margin in addition to its swapped 4.25% payment obligation.

Interest rate hedges that are designated as cash flow hedges hedge the future cash outflows on debt. Interest rate swaps that convert variable payments to fixed payments, interest rate caps, floors, collars and forwards are cash flow hedges. The unrealized gains/losses in the fair value of these hedges are reported on the balance sheet and included in other long-term liabilities with a corresponding adjustment to either accumulated other comprehensive income/(loss) or in earnings depending on the hedging relationship. If the hedging transaction is a cash flow hedge, then the offsetting gains/losses are reported in accumulated other comprehensive income/(loss). Over time, the unrealized gains/losses held in accumulated other comprehensive income/(loss) will be recognized in earnings consistent with when the hedged items are recognized in earnings.

Under the interest rate swap, the Company pays the bank at a fixed rate and receives variable interest at a rate approximating the variable rate of the Company's debt, thereby creating the equivalent of a fixed rate obligation. The following table summarizes the original financial terms of the Company's interest rate swap:

| <u>Notional Value</u> | <u>Variable Rate Received</u> | <u>Fixed Rate Paid</u> | <u>Effective Date</u> | <u>Expiration Date</u> |
|-----------------------|-------------------------------|------------------------|-----------------------|------------------------|
| \$2,950,000           | LIBOR                         | 4.25%                  | 1/1/02                | 12/1/04                |

The notional value of the interest rate swap declines as the amount of the Term Loan is paid down. At December 31, 2002, the notional value of the swap was \$2,350,000. Increases in prevailing interest rates could increase the Company's interest payment obligations relating to variable rate debt. For example, a 100 basis points increase in interest rates would increase annual interest expense by \$51,000, based on debt levels at December 31, 2002.

## Item 8. Financial Statements and Supplementary Data

The information required by this item is set forth under Item 15(a), which information is incorporated herein by reference.

## Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

**PART IV**

**Item 15. Exhibits, Financial Statement Schedules, and Reports on Form 8-K**

**(a) (1) Financial Statements**

|   |     |
|---|-----|
| Report of Independent Auditors .....  | F-1 |
| Consolidated Balance Sheets as of December 31, 2002 and 2001 .....  | F-2 |
| Consolidated Statements of Operations for the years ended December 31, 2002 and 2001, the six-month period ended December 31, 2000, the unaudited six-month period ended December 31, 1999, and the fiscal year ended June 30, 2000 ..... | F-3 |
| Consolidated Statements of Shareholders' Equity for the year ended December 31, 2002 and 2001, the six-month period ended December 31, 2000, and the fiscal year ended June 30, 2000 .....  | F-4 |
| Consolidated Statements of Cash Flows for the year ended December 31, 2002 and 2001, the six-month period ended December 31, 2000, the unaudited six-month period ended December 31, 1999, and the fiscal year ended June 30, 2000 .....  | F-5 |
| Notes to Consolidated Financial Statements .....  | F-6 |

**(a) (2) Financial Statement Schedules**

All schedules are omitted since the required information is not present or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements and notes thereto.

**(a) (3) Exhibits**

**Exhibit  
No.**

- 2.1 Stock Purchase Agreement dated as of December 18, 1998 among Jeannine Mantz, Hadron, Inc., and Vail Research and Technology Corporation (incorporated by reference to the Company's Current Report on Form 8-K filed January 4, 1999, Exhibit No. 2.2).
- 2.2 Stock Purchase Agreement dated as of May 12, 1999 among Hadron, Inc., Avenue Technologies, Inc. and Six Nations, Inc. (incorporated by reference to the Company's Current Report on Form 8-K filed May 27, 1999, Exhibit No. 2.1).
- 2.3 Agreement and Plan of Merger by and among Analex Corporation, certain Sellers, Analex Corporation Employee Stock Ownership Plan and Trust, Hadron, Inc. and Hadron Acquisition Corp., as of October 31, 2001 (previously filed).
- 3.1 Certificate of Incorporation (incorporated by reference to the Company's Form 10-Q for the fiscal quarter ended June 30, 2002 and filed with the Commission on August 14, 2002).
- 3.2 Bylaws (incorporated by reference to the Company's Form 10-Q for the fiscal quarter ended June 30, 2002 and filed with the Commission on August 14, 2002).
- 3.3 Certificate of Amendment of Certificate of Incorporation, dated November 19, 2002 (incorporated by reference to the Company's form 10-Q for the fiscal quarter ended June 30, 2002 and filed with the Commission on August 14, 2002).

| <u>Exhibit<br/>No.</u> |   |
|------------------------|---|
| 3.4                    | Certificate of Amendment of Certificate of Incorporation, dated June 25, 2002 (incorporated by reference to the Company's Form 10-Q for the fiscal quarter ended June 30, 2002 and filed with the Commission on August 14, 2002).   |
| 10.1                   | Hadron, Inc. 1997 Employee Stock Purchase Plan (incorporated by reference to the Company's Proxy Statement dated October 28, 1997).   |
| 10.2                   | Amended Stock Purchase Warrant issued to C.W. Gilluly and dated June 2, 1997 (incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 1999 and filed with the Commission on September 28, 1999, Exhibit No. 10.11).  |
| 10.3                   | Stock Purchase Warrant for the purchase of 430,000 shares of common stock issued to C.W. Gilluly by the Company dated February 15, 2000 (incorporated by reference to the Company's Form 10-Q for the fiscal quarter ended March 31, 2000 and filed with the Commission on May 15, 2000, Exhibit No. 10.2). |
| 10.4                   | First Amendment to the Hadron, Inc. 1997 Employee Stock Purchase Plan dated as of February 7, 2000 (incorporated by reference to the Company's Form S-8 filed with the Commission on February 7, 2000, Exhibit No. 99.1).   |
| 10.5                   | First Amendment to the Hadron, Inc. 1994 Stock Option Plan, dated as of September 17, 1997 (incorporated by reference to the Company's Form S-8 filed with the Commission on February 7, 2000, Exhibit No. 99.1).   |
| 10.6                   | Warrant issued to Jon M. Stout to purchase up to 235,161 shares of Hadron, Inc.'s Common Stock (incorporated by reference to the Form 8-K filed with the Commission on April 14, 2000, Exhibit No. 4.1).  |
| 10.7                   | Warrant issued to Patricia W. Stout to purchase up to 230,769 shares of Hadron, Inc.'s Common Stock (incorporated by reference to the Form 8-K filed with the Commission on April 14, 2000, Exhibit No. 4.2).   |
| 10.8                   | Warrant issued to Stout Dynastic Trust up to 1,015,380 shares of Hadron, Inc.'s Common Stock (incorporated by reference to the Form 8-K filed with the Commission on April 14, 2000, Exhibit No. 4.3).  |
| 10.9                   | Warrant issued to J. Richard Knop to purchase up to 462,690 shares of Hadron, Inc.'s Common Stock (incorporated by reference to the Form 8-K filed with the Commission on April 14, 2000, Exhibit No. 4.4).   |
| 10.10                  | Warrant issued to John D. Sanders to purchase up to 81,000 shares of Hadron, Inc.'s Common Stock (incorporated by reference to the Form 8-K filed with the Commission on April 14, 2000, Exhibit No. 4.5).  |
| 10.11                  | Voting Agreement among certain holders of the common stock of Hadron, Inc., C.W. Gilluly and Jon M. Stout, Patricia W. Stout, the Stout Dynastic Trust and J. Richard Knop dated March 30, 2000 (incorporated by reference to the Form 8-K filed with the Commission on April 14, 2000, Exhibit No. 9.1).   |
| 10.12                  | Severance Agreement between the Company and Donald Kellmel dated May 23, 2000 (incorporated by reference to the Form 10-K for the transition period ended December 31, 2000 and filed with the Commission on May 11, 2001, Exhibit No. 10.28).  |
| 10.13                  | Hadron, Inc. 2000 Employee Stock Option Plan (incorporated by reference to the Form 10-Q for the period ended June 30, 2003, Exhibit 10.3).   |
| 10.14                  | Second Amendment to the Hadron, Inc. 1997 Employee Stock Purchase Plan dated as of February 7, 2000 (incorporated by reference to the Company's Form S-8 filed with the Commission on May 8, 2001, Exhibit 99.1).   |

| <u>Exhibit<br/>No.</u> |  |
|------------------------|--|
| 10.15                  | Form of Amendment to Employment Agreement between Jon M. Stout and the Company dated January 16, 2001 (incorporated by reference to the exhibits filed with the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2001 filed with the Commission on August 14, 2001, Exhibit No. 10.2).   |
| 10.16                  | Form of Employment Agreement between the Company and Sterling E. Phillips, Jr. dated January 16, 2001 (incorporated by reference to the exhibits filed with the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2001 filed with the Commission on August 14, 2001, Exhibit No. 10.3).   |
| 10.17                  | Promissory Note between Peter C. Belford, Sr. and Hadron, Inc. dated November 5, 2001, pursuant to the Agreement and Plan of Merger between Hadron, Inc. and Analex Corporation (incorporated by reference to the exhibits filed with the Company's Form 10-K for the year ended December 31, 2001 filed with the Commission on March 26, 2002, Exhibit No. 10.24).  |
| 10.18                  | Promissory Note between Lese Ann Kodger and Hadron, Inc. dated November 5, 2001, pursuant to the Agreement and Plan of Merger between Hadron, Inc. and Analex Corporation (incorporated by reference to the exhibits filed with the Company's Form 10-K for the year ended December 31, 2001 filed with the Commission on March 26, 2002, Exhibit No. 10.25).  |
| 10.19                  | Promissory Note between Alex Patterson and Hadron, Inc. dated November 5, 2001, pursuant to the Agreement and Plan of Merger between Hadron, Inc. and Analex Corporation (incorporated by reference to the exhibits filed with the Company's Form 10-K for the year ended December 31, 2001 filed with the Commission on March 26, 2002, Exhibit No. 10.26).   |
| 10.20                  | Employment Agreement of Peter C. Belford, Sr. dated November 5, 2001 (previously filed).   |
| 10.21                  | Credit Agreement between Hadron, Inc. and Bank of America, N.A. dated November 2, 2001 (previously filed).   |
| 10.22                  | Security Agreement between Hadron, Inc. and Bank of America, N.A. dated November 2, 2001 (incorporated by reference to the exhibits filed with the Company's Form 10-K for the year ended December 31, 2001 filed with the Commission on March 26, 2002, Exhibit No. 10.29).   |
| 10.23                  | Pledge Agreement between Hadron, Inc. and Bank of America, N.A. dated November 2, 2001 (incorporated by reference to the exhibits filed with the Company's Form 10-K for the year ended December 31, 2001 filed with the Commission on March 26, 2002, Exhibit No. 10.30).   |
| 10.24                  | Hadron, Inc. Term Loan Note between Hadron, Inc. and Bank of America, N.A. dated November 2, 2001 (incorporated by reference to the exhibits filed with the Company's Form 10-K for the year ended December 31, 2001 filed with the Commission on March 26, 2002, Exhibit No. 10.31).  |
| 10.25                  | Hadron, Inc. Revolving Credit Facility Note between Hadron, Inc. and Bank of America, N.A. dated November 2, 2001 (incorporated by reference to the exhibits filed with the Company's Form 10-K for the year ended December 31, 2001 filed with the Commission on March 26, 2002, Exhibit No. 10.32).  |
| 10.26                  | Form of Securities Purchase Agreement between Hadron, Inc., Gerald McNichols, Michael Besche, VBB Trust, S Co., LLC, RSSJ Associates, LLC, Norman Dreyfuss, Deepak Chopra, George Tonn and Frank Derwin dated November 2, 2001 (incorporated by reference to the exhibits filed with the Company's Form 10-K for the year ended December 31, 2001 filed with the Commission on March 26, 2002, Exhibit No. 10.33). |

| <u>Exhibit<br/>No.</u> |  |
|------------------------|--|
| 10.27                  | Form of Warrant to Purchase Shares of Common Stock of Hadron, Inc. issued in connection with Securities Purchase Agreement dated November 2, 2001 (incorporated by reference to the exhibits filed with the Company's Form 10-K for the year ended December 31, 2001 filed with the Commission on March 26, 2002, Exhibit No. 10.34).  |
| 10.28                  | Warrant to Purchase Shares of Common Stock issued to J. Richard Knop in Guarantee of Bank of America Loan dated November 2, 2001 (incorporated by reference to the exhibits filed with the Company's Form 10-K for the year ended December 31, 2001 filed with the Commission on March 26, 2002, Exhibit No. 10.35).   |
| 10.29                  | Warrant to Purchase Shares of Common Stock issued to Gerald McNichols in Guarantee of Bank of American Loan dated November 2, 2001 (incorporated by reference to the exhibits filed with the Company's Form 10-K for the year ended December 31, 2001 filed with the Commission on March 26, 2002, Exhibit No. 10.36).   |
| 10.30                  | Continuing and Unconditional Guaranty between Bank of America, N.A. and Subsidiaries (Advanced Biosystems, Inc.; Avenue Technologies, Inc.; Engineering and Information Services, Inc.; Sycom Services, Inc.; Vail Research and Technology Corporation; and Hadron Acquisition Corp.) dated November 2, 2001 (incorporated by reference to the exhibits filed with the Company's Form 10-K for the year ended December 31, 2001 filed with the Commission on March 26, 2002, Exhibit No. 10.37). |
| 10.31                  | Expendable Launch Vehicle Integrated Support (ELVIS) contract by and between the Registrant and The National Aeronautics and Space Administration (NASA) (incorporated by reference to the Company's Form 10-Q for the fiscal quarter ended June 30, 2002 and filed with the Commission on August 14, 2002, Exhibit No. 10.38).  |
| 10.32                  | 2002 Stock Option Plan (incorporated by reference to the Company's Form 10-Q for the fiscal quarter ended June 30, 2002 and filed with the Commission on August 14, 2002, Exhibit No. 10.39).  |
| 10.33                  | First Amendment To Credit Agreement between Analex Corporation and Bank of America dated August 1, 2002 (previously filed).  |
| 10.34                  | Second Amendment To Credit Agreement between Analex Corporation and Bank of America dated December 20, 2002 (previously filed).  |
| 10.35                  | Amendment effective as of November 1, 2002, to Voting Agreement, dated as of March 30, 2000, among certain holders of the Company's common stock, C.W. Gilluly, Jon M. Stout, Patricia W. Stout, the Stout Dynastic Trust and J. Richard Knop (previously filed).  |
| 21                     | Subsidiaries of the Company (previously filed).  |
| 23                     | Consent of Independent Auditors (filed herewith).  |
| 31.1                   | Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).  |
| 31.2                   | Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).  |
| 32.1                   | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).   |

**(b) Reports on Form 8-K**

None.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Date: November 6, 2003

ANALEX CORPORATION

By: /s/ STERLING E. PHILLIPS, JR.  
**Sterling E. Phillips, Jr.**  
**Chief Executive Officer and President**  
**(Principal Executive Officer)**

By: /s/ RONALD B. ALEXANDER  
**Ronald B. Alexander**  
**Chief Financial Officer**  
**(Principal Financial Officer and Principal Accounting Officer)**

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| <u>Signature</u>  | <u>Title</u> | <u>Date</u>             |
|---|--------------|-------------------------|
| <u>/s/ STERLING E. PHILLIPS, JR.*</u><br>Jon M. Stout             | Chairman     | <u>November 6, 2003</u> |
| <u>/s/ STERLING E. PHILLIPS, JR.*</u><br>Peter C. Belford, Sr.    | Director     | <u>November 6, 2003</u> |
| <u>/s/ STERLING E. PHILLIPS, JR.*</u><br>Lincoln D. Faurer        | Director     | <u>November 6, 2003</u> |
| <u>/s/ STERLING E. PHILLIPS, JR.*</u><br>Alan L. Kaplan           | Director     | <u>November 6, 2003</u> |
| <u>/s/ STERLING E. PHILLIPS, JR.*</u><br>Gerald R. McNichols      | Director     | <u>November 6, 2003</u> |
| <u>/s/ STERLING E. PHILLIPS, JR.</u><br>Sterling E. Phillips, Jr. | Director     | <u>November 6, 2003</u> |
| <u>/s/ STERLING E. PHILLIPS, JR.*</u><br>Shawna L. Stout          | Director     | <u>November 6, 2003</u> |
| <u>/s/ STERLING E. PHILLIPS, JR.*</u><br>Daniel R. Young          | Director     | <u>November 6, 2003</u> |

\* By power of attorney

## REPORT OF INDEPENDENT AUDITORS

Board of Directors and Shareholders  
Analex Corporation

We have audited the accompanying consolidated balance sheets of Analex Corporation and subsidiaries as of December 31, 2002 and 2001 and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the two years in the period ended December 31, 2002, the six-month transition period ended December 31, 2000 and the year ended June 30, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Analex Corporation and subsidiaries at December 31, 2002 and 2001, and the consolidated results of their operations and their cash flows for each of the two years in the period ended December 31, 2002, the six-month transition period ended December 31, 2000 and the year ended June 30, 2000, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 2 to the consolidated financial statements, the Company changed its accounting for goodwill and intangible assets, which was effective in 2001 for acquisitions subsequent to July 1, 2001, and January 1, 2002 for all acquisitions prior to July 1, 2001.

/s/ ERNST & YOUNG LLP

McLean, Virginia  
February 14, 2003



**ANALEX CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**  
**DECEMBER 31, 2002 AND DECEMBER 31, 2001**

|  | <u>December 31,<br/>2002</u> | <u>December 31,<br/>2001</u> |
|--|------------------------------|------------------------------|
| <b>ASSETS</b>  |                              |                              |
| Current assets:  |                              |                              |
| Cash and cash equivalents .....  | \$ 301,800                   | \$ 83,100                    |
| Accounts receivable, net .....   | 12,556,100                   | 8,377,600                    |
| Prepaid expenses and other .....   | 270,500                      | 223,300                      |
| Total current assets .....   | <u>13,128,400</u>            | <u>8,684,000</u>             |
| Fixed assets, net .....  | 216,700                      | 260,600                      |
| Goodwill .....   | 15,534,600                   | 15,638,100                   |
| Contract rights and other intangibles, net .....   | 1,770,200                    | 850,500                      |
| Deferred finance costs .....   | 75,900                       | 72,500                       |
| Other .....  | 58,400                       | 119,400                      |
| Total other assets .....   | <u>17,655,800</u>            | <u>16,941,100</u>            |
| Total assets .....   | <u><u>\$30,784,200</u></u>   | <u><u>\$25,625,100</u></u>   |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                              |                              |
| Current liabilities:   |                              |                              |
| Accounts payable .....   | \$ 3,294,700                 | \$ 1,371,400                 |
| Note payable—line of credit .....  | 2,187,700                    | 1,696,500                    |
| Note payable— bank term note .....   | 700,000                      | 700,000                      |
| Notes payable—other .....  | 1,012,100                    | 838,500                      |
| Other current liabilities .....  | 5,258,400                    | 4,779,400                    |
| Total current liabilities .....  | <u>12,452,900</u>            | <u>9,385,800</u>             |
| Note payable—bank term note .....  | 2,041,700                    | 2,741,600                    |
| Notes payable—other .....  | 2,297,200                    | 2,262,600                    |
| Other .....  | 90,600                       | 60,000                       |
| Total long-term liabilities .....  | <u>4,429,500</u>             | <u>5,064,200</u>             |
| Total liabilities .....  | <u>16,882,400</u>            | <u>14,450,000</u>            |
| Commitments and contingencies  |                              |                              |
| Shareholders' equity:  |                              |                              |
| Common stock \$.02 par; authorized 30,000,000 shares; issued and outstanding—<br>December 31, 2002 14,427,080 shares and December 31, 2001, 14,375,975<br>shares ..... | 288,500                      | 287,500                      |
| Additional capital .....   | 21,171,400                   | 20,726,300                   |
| Deferred compensation .....  | (7,700)                      | (22,300)                     |
| Accumulated other comprehensive loss .....   | (90,600)                     | —                            |
| Accumulated deficit .....  | <u>(7,459,800)</u>           | <u>(9,816,400)</u>           |
| Total shareholders' equity .....   | <u>13,901,800</u>            | <u>11,175,100</u>            |
| Total liabilities and shareholders' equity .....   | <u><u>\$30,784,200</u></u>   | <u><u>\$25,625,100</u></u>   |

See Notes to Consolidated Financial Statements

**ANALEX CORPORATION**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001,**  
**THE SIX MONTH PERIOD ENDED DECEMBER 31, 2000,**  
**THE SIX MONTH UNAUDITED PERIOD ENDED DECEMBER 31, 1999, AND**  
**THE FISCAL YEAR ENDED JUNE 30, 2000**

|   | <u>Year Ended<br/>December 31,<br/>2002</u> | <u>Year Ended<br/>December 31,<br/>2001</u> | <u>Six Month<br/>Period<br/>Ended<br/>December 31,<br/>2000</u> | <u>Six Months<br/>Ended<br/>December 31,<br/>1999<br/>Unaudited</u> | <u>Fiscal Year<br/>Ended<br/>June 30,<br/>2000</u> |
|---|---|---|---|---|--|
| Revenues . . . . .  | \$59,317,000                                | \$21,936,000                                | \$8,943,400   | \$10,267,300  | \$19,901,300                                       |
| Operating costs and expenses:                               |   |   |   |   |  |
| Costs of revenue . . . . .                                  | 50,436,700                                  | 18,157,800                                  | 7,600,700   | 8,753,200   | 16,572,200   |
| Selling, general and<br>administrative . . . . .            | 5,048,700                                   | 2,967,600                                   | 984,000   | 1,823,300   | 3,411,900  |
| Amortization of goodwill and<br>other intangibles . . . . . | 307,600                                     | 378,400                                     | 169,000   | 171,900   | 338,000  |
| Total operating costs and expenses . . .                    | <u>55,793,000</u>                           | <u>21,503,800</u>                           | <u>8,753,700</u>  | <u>10,748,400</u>   | <u>20,322,100</u>                                  |
| Operating income (loss) . . . . .                           | <u>3,524,000</u>                            | <u>432,200</u>                              | <u>189,700</u>  | <u>(481,100)</u>  | <u>(420,800)</u>                                   |
| Other income (expense):                                     |   |   |   |   |  |
| Interest income . . . . .                                   | —   | 8,600                                       | —   | 600   | 8,100  |
| Interest expense . . . . .                                  | (1,018,300)                                 | (225,200)                                   | (112,000)   | (167,100)   | (332,600)  |
| Other income . . . . .                                      | —   | —   | 7,100   | 16,600  | 21,800   |
| Total other expense . . . . .                               | <u>(1,018,300)</u>                          | <u>(216,600)</u>                            | <u>(104,900)</u>  | <u>(149,900)</u>  | <u>(302,700)</u>                                   |
| Income (loss) before income taxes . . . .                   | 2,505,700                                   | 215,600                                     | 84,800  | (631,000)   | (723,500)  |
| Provision for income taxes . . . . .                        | 149,100                                     | 19,600                                      | —   | —   | 21,300   |
| Net income (loss) . . . . .                                 | <u>\$ 2,356,600</u>                         | <u>\$ 196,000</u>                           | <u>\$ 84,800</u>  | <u>\$ (631,000)</u>   | <u>\$ (744,800)</u>                                |
| Net income (loss) per share:                                |   |   |   |   |  |
| Basic . . . . .   | <u>\$ 0.16</u>                              | <u>\$ 0.03</u>                              | <u>\$ 0.01</u>  | <u>\$ (0.24)</u>  | <u>\$ (0.23)</u>                                   |
| Diluted . . . . .   | <u>\$ 0.14</u>                              | <u>\$ 0.02</u>                              | <u>\$ 0.01</u>  | <u>\$ (0.24)</u>  | <u>\$ (0.23)</u>                                   |
| Weighted average number of shares:                          |   |   |   |   |  |
| Basic . . . . .   | <u>14,412,554</u>                           | <u>7,721,779</u>                            | <u>6,153,914</u>  | <u>2,599,915</u>  | <u>3,276,269</u>                                   |
| Diluted . . . . .   | <u>17,081,651</u>                           | <u>9,588,029</u>                            | <u>7,118,895</u>  | <u>2,599,915</u>  | <u>3,276,269</u>                                   |

See Notes to Consolidated Financial Statements

**ANALEX CORPORATION**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
**FOR THE YEARS ENDED DECEMBER 31, 2002, DECEMBER 31, 2001,**  
**THE SIX MONTH PERIOD ENDED DECEMBER 31, 2000**  
**AND THE FISCAL YEAR ENDED JUNE 30, 2000**

|   | Common Stock      |                  | Additional Capital  | Deferred Compensation | Accumulated Other Comprehensive Loss | Accumulated Deficit   | Total               |
|---|-------------------|------------------|---------------------|-----------------------|--------------------------------------|-----------------------|---------------------|
|   | Shares            | Amount           |                     |                       |                                      |                       |                     |
| Balance—June 30, 1999   | 2,487,518         | \$ 49,700        | \$ 9,758,300        | \$ —                  | \$ —                                 | \$ (9,352,400)        | \$ 455,600          |
| Shares purchased pursuant to the Employee Stock Purchase Plan     | 118,722           | 2,400            | 48,000              |                       |                                      |                       | 50,400              |
| Exercise of warrants  | 220,000           | 4,400            | 50,600              |                       |                                      |                       | 55,000              |
| Exercise of options   | 78,166            | 1,600            | 27,000              |                       |                                      |                       | 28,600              |
| Shares issued upon conversion of debt                             | 676,933           | 13,500           | 842,100             |                       |                                      |                       | 855,600             |
| Shares issued pursuant to sale of common stock                    | 2,250,000         | 45,000           | 790,000             |                       |                                      |                       | 835,000             |
| Net loss  |                   |                  |                     |                       |                                      | (744,800)             | (744,800)           |
| Balance—June 30, 2000   | 5,831,339         | 116,600          | 11,516,000          | —                     | —                                    | (10,097,200)          | 1,535,400           |
| Shares purchased pursuant to the Employee Stock Purchase Plan     | 19,180            | 400              | 13,900              |                       |                                      |                       | 14,300              |
| Exercise of warrants  | 462,894           | 9,300            | 324,000             |                       |                                      |                       | 333,300             |
| Exercise of options   | 62,500            | 1,200            | 25,300              |                       |                                      |                       | 26,500              |
| Shares issued pursuant to sale of common stock                    | 75,000            | 1,500            | 6,100               |                       |                                      |                       | 7,600               |
| Net income  |                   |                  |                     |                       |                                      | 84,800                | 84,800              |
| Balance—December 31, 2000   | 6,450,913         | 129,000          | 11,885,300          | —                     | —                                    | (10,012,400)          | 2,001,900           |
| Shares issued pursuant to sale of common stock                    | 4,027,727         | 80,600           | 3,837,000           |                       |                                      |                       | 3,917,600           |
| Shares and warrants issued pursuant to acquisition of Analex      | 3,572,143         | 71,400           | 4,687,200           |                       |                                      |                       | 4,758,600           |
| Deferred stock compensation                                       |                   |                  | 38,800              | (38,800)              |                                      |                       | —                   |
| Amortization of deferred stock compensation                       |                   |                  |                     | 16,500                |                                      |                       | 16,500              |
| Shares purchased pursuant to the Employee Stock Purchase Plan     | 39,964            | 800              | 40,400              |                       |                                      |                       | 41,200              |
| Exercise of options and warrants                                  | 285,228           | 5,700            | 237,600             |                       |                                      |                       | 243,300             |
| Net income  |                   |                  |                     |                       |                                      | 196,000               | 196,000             |
| Balance—December 31, 2001   | 14,375,975        | 287,500          | 20,726,300          | (22,300)              | —                                    | (9,816,400)           | 11,175,100          |
| Amortization of deferred stock compensation                       |                   |                  |                     | 14,600                |                                      |                       | 14,600              |
| Warrants issued pursuant to bank guarantee                        |                   |                  | 345,400             |                       |                                      |                       | 345,400             |
| Shares returned and retired in connection with Analex acquisition | (51,804)          | (1,000)          | (58,000)            |                       |                                      |                       | (59,000)            |
| Shares purchased pursuant to the Employee Stock Purchase Plan     | 81,739            | 1,600            | 139,100             |                       |                                      |                       | 140,700             |
| Exercise of options and warrants                                  | 21,170            | 400              | 18,600              |                       |                                      |                       | 19,000              |
| Unrealized loss on derivative contract                            |                   |                  |                     |                       | (90,600)                             |                       | (90,600)            |
| Net income  |                   |                  |                     |                       |                                      | 2,356,600             | 2,356,600           |
| Total comprehensive income  |                   |                  |                     |                       |                                      |                       | 2,266,000           |
|   | <u>14,427,080</u> | <u>\$288,500</u> | <u>\$21,171,400</u> | <u>\$ (7,700)</u>     | <u>\$(90,600)</u>                    | <u>\$ (7,459,800)</u> | <u>\$13,901,800</u> |

See Notes to Consolidated Financial Statements

**ANALEX CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001,**  
**THE SIX MONTH PERIOD ENDED DECEMBER 31, 2000,**  
**THE SIX MONTH UNAUDITED PERIOD ENDED DECEMBER 31, 1999, AND**  
**THE FISCAL YEAR ENDED JUNE 30, 2000**

|  | Year Ended<br>December 31,<br>2002 | Year Ended<br>December 31,<br>2001 | Six Month<br>Period<br>Ended<br>December 31,<br>2000 | Six Months<br>Ended<br>December 31,<br>1999<br>Unaudited | Fiscal Year<br>Ended<br>June 30,<br>2000 |
|--|------------------------------------|------------------------------------|--|--|--|
| Cash flows from operating activities:  |                                    |                                    |  |  |  |
| Net income (loss) .....  | \$ 2,356,600                       | \$ 196,000                         | \$ 84,800  | \$ (631,000)   | \$ (744,800)                             |
| Adjustments to reconcile net income (loss) to net cash<br>provided (used) by operating activities: |                                    |                                    |  |  |  |
| Depreciation .....   | 111,400                            | 146,200                            | 67,500   | 36,700   | 113,300                                  |
| Amortization of goodwill and other intangibles ..  | 307,600                            | 378,000                            | 162,000  | 172,000  | 344,000                                  |
| Non-cash interest expense .....  | 345,400                            | 37,500                             | —  | —  | —  |
| Stock compensation expense .....   | 14,600                             | 16,500                             | —  | —  | —  |
| Changes in operating assets and liabilities:   |                                    |                                    |  |  |  |
| Accounts receivable .....  | (4,278,500)                        | (940,700)                          | 217,200  | 141,400  | 41,200                                   |
| Prepaid expenses and other .....   | (47,200)                           | (39,100)                           | (35,000)   | 89,800   | 81,300                                   |
| Other assets .....   | 57,600                             | (11,300)                           | 5,200  | 86,200   | 86,500                                   |
| Accounts payable .....   | 1,923,300                          | 108,600                            | (250,200)  | (123,200)  | (137,400)                                |
| Other current liabilities .....  | 478,100                            | (327,100)                          | (289,300)  | (135,700)  | (268,800)                                |
| Other long-term liabilities .....  | 30,600                             | —                                  | (40,000)   | (20,800)   | 37,400                                   |
| Total adjustments .....  | (1,057,100)                        | (631,400)                          | (162,600)  | 246,400  | 297,500                                  |
| Net cash provided (used) by operating activities .....   | 1,299,500                          | (435,400)                          | (77,800)   | (384,600)  | (447,300)                                |
| Cash flows from investing activities:  |                                    |                                    |  |  |  |
| Purchase of Analex, net of cash acquired .....   | —                                  | (6,167,900)                        | —  | —  | —  |
| Property additions .....   | (67,100)                           | (86,000)                           | (132,800)  | (2,400)  | (41,600)                                 |
| Intangible additions .....   | (172,900)                          | —                                  | —  | —  | —  |
| Net cash used in investing activities .....  | (240,000)                          | (6,253,900)                        | (132,800)  | (2,400)  | (41,600)                                 |
| Cash flows from financing activities:  |                                    |                                    |  |  |  |
| Proceeds from borrowings on banks and other<br>loans .....   | 491,200                            | 5,500,000                          | 1,326,400  | 1,496,600  | 1,926,600                                |
| Proceeds from stock options and warrants<br>exercised .....  | 19,000                             | 243,300                            | 359,800  | 58,800   | 83,600                                   |
| Proceeds from sale of common stock .....   | —                                  | 3,917,600                          | 7,600  | —  | 835,000                                  |
| Proceeds from employee stock purchases .....   | 140,700                            | 41,200                             | 14,300   | 36,700   | 50,400                                   |
| Payments on bank and other loans .....   | (1,491,700)                        | (3,164,600)                        | (1,380,600)  | (1,267,900)  | (2,544,700)                              |
| Net cash provided (used) by financing activities .....   | (840,800)                          | 6,537,500                          | 327,500  | 324,200  | 350,900                                  |
| Net increase (decrease) in cash and cash equivalents ..  | 218,700                            | (151,800)                          | 116,900  | (62,800)   | (138,000)                                |
| Cash and cash equivalents at beginning of period .....   | 83,100                             | 234,900                            | 118,000  | 256,000  | 256,000                                  |
| Cash and cash equivalents at end of period .....   | <u>\$ 301,800</u>                  | <u>\$ 83,100</u>                   | <u>\$ 234,900</u>                                    | <u>\$ 193,200</u>  | <u>\$ 118,000</u>                        |

See Notes to Consolidated Financial Statements

**ANALEX CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. The Company:**

Analex Corporation (“Analex” or the “Company”) specializes in providing information technology, engineering and bio-defense services and solutions in support of our nation’s security. Analex focuses on developing innovative technical approaches for the intelligence community, analyzing and supporting defense systems, designing, developing and testing aerospace systems and developing medical defenses and treatments for infectious agents used in biological warfare and terrorism. Analex has three strategic business units. The Homeland Security Group provides information technology services, systems integration, hardware and software engineering and independent quality assurance in support of the U.S. intelligence community and Department of Defense. The Systems Engineering Group provides engineering, information technology and program management support to NASA, the Department of Defense, and major aerospace contractors such as Lockheed Martin and Northrop Grumman. Advanced Biosystems, Inc. a wholly owned subsidiary, focuses on development of medical defenses against, and treatments for, biological warfare agents that threaten military and civilian populations.

Revenues from services performed under direct and indirect long-term contracts and subcontracts with government defense and intelligence agencies comprise the majority of the Company’s business. The majority of the Company’s technical and professional services business with governmental departments and agencies is obtained through competitive procurement and through follow-on services related to existing contracts. In certain instances, however, the Company acquires such service contracts because of special professional competency or proprietary knowledge in specific subject areas.

**2. Summary of significant accounting policies:**

**A. Principles of consolidation:**

The consolidated financial statements include the accounts of Analex Corporation and its two active wholly owned subsidiaries, Advanced Biosystems, Inc. (“ABS”), and SyCom Services, Inc. (“SyCom”). All significant intercompany transactions have been eliminated.

**B. Risks and uncertainties:**

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, and accounts receivable. The Company maintains its cash and cash equivalents principally in one United States (“U.S.”) commercial bank. Cash in excess of daily requirements is invested by the bank in one-day repurchase agreements of securities of U.S. government agencies. To date, the Company has not incurred losses related to cash and cash equivalents.

The Company’s accounts receivable consists principally of accounts receivable from prime contractors to agencies and departments of, as well as directly from, the U.S. government. The Company extends credit in the normal course of operations and does not require collateral from its customers.

The Company has historically been, and continues to be, heavily dependent upon direct and indirect contracts from various U.S. government agencies. Contracts and subcontracts with the U.S. government are subject to audit by audit agencies of the government. Such audits determine, among other things, whether an adjustment of invoices rendered to the government is appropriate under the underlying terms of the contracts. All U.S. government contracts contain clauses that allow for the termination of contracts at the convenience of the government.

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the reported amounts of assets,

## ANALEX CORPORATION

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

liabilities and contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

#### **C. Cash equivalents:**

Cash equivalents represent amounts invested in highly liquid short-term investments with original maturities of three months or less.

#### **D. Fixed assets:**

Furniture and equipment and leasehold improvements are stated at cost or fair value if acquired in a business combination. The Company uses the straight-line method of depreciation and amortization over the estimated useful lives of the furniture and equipment (principally three to ten years) and over the lease term for leasehold improvements, if shorter.

Maintenance and repairs are charged to expense as incurred, and the cost of additions and betterments are capitalized. When assets are retired or sold, the cost and related accumulated depreciation are removed from the accounts and the gain or loss is included in operations.

Purchased software is capitalized at cost. Such costs are amortized using the straight-line method for a period of up to five years.

#### **E. Goodwill and Other Intangible Assets:**

On January 1, 2002, the Company adopted the provisions of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*, (SFAS No. 142). SFAS No. 142 was issued in June 2001 and became effective for fiscal years beginning after December 15, 2001. SFAS No. 142 requires that goodwill and intangible assets with indefinite lives no longer be amortized but reviewed annually (or more frequently if impairment indicators arise) for impairment. Intangible assets that are not deemed to have indefinite lives will continue to be amortized over their useful lives. In accordance with SFAS No. 142 transitional requirements, with respect to goodwill and intangible assets acquired prior to July 1, 2001, the Company adopted the provisions of SFAS No. 142 effective January 1, 2002, and as a result, amortization of goodwill was discontinued. In accordance with SFAS No. 142 transitional requirements, with respect to goodwill and intangible assets acquired after June 30, 2001, the Company adopted the provisions of SFAS No. 142 effective July 1, 2001 and as a result, goodwill acquired after June 30, 2001 has not been amortized. All goodwill is assigned to the Company's reportable segment Analex.

**ANALEX CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**F. Accounting for contracts:**

The Company's contracts with customers are typically cost plus fee, time and materials, or fixed-price contracts. Revenues result from work performed on these contracts by the Company's employees and from pass-through of costs for material and work performed by subcontractors. Revenues on cost-type contracts are recorded as contract allowable costs are incurred and fees earned. Revenues for time and materials contracts are recorded on the basis of contract allowable labor hours worked times the contract defined billing rates, plus the cost of materials used in performance on the contract. Profits on time and material contracts result from the difference between the cost of services performed and the contract defined billing rates for these services. Revenues on certain fixed-price service contracts are recorded each period based on a monthly amount for services provided in accordance with the terms of the contract. Costs related to such contracts are expensed as incurred. In accordance with AICPA Statement of Position No. 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*, revenues on fixed-price construction-type contracts, for which the Company can reasonably estimate total contract costs, are recorded as costs are incurred, using the percentage-of-completion method of accounting. Profits on fixed-price contracts result from the difference between the incurred costs and the revenue earned. In the normal course of business, the Company may be party to claims and disputes resulting from modifications and change orders and other contract matters. Claims for additional contract compensation are recognized when realization is probable and estimable.

In accordance with industry practice, accounts receivable relating to long-term contracts are classified as current assets although an indeterminable portion of these amounts is not expected to be realized within one year.

**G. Stock-based compensation:**

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure—an amendment of SFAS No. 123." This statement amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company has chosen to continue to account for stock-based compensation using the intrinsic value method prescribed in APB Opinion No. 25 and related interpretations. Accordingly, compensation expense for stock options is measured as the excess, if any, of the fair market value of the company's stock at the date of the grant over the exercise price of the related option. The company has adopted the annual disclosure provisions of SFAS No. 148 in its financial reports for the year ended December 31, 2002 and will adopt the interim disclosure provisions for its financial reports for the quarter ending March 31, 2003.

|   | <u>2002</u> | <u>2001</u> | <u>6 mos<br/>12/00</u> | <u>6 mos<br/>12/99</u> | <u>2000</u> |
|---|-------------|-------------|------------------------|------------------------|-------------|
| Net income as reported .....  | \$2,356,600 | \$ 196,000  | \$84,800               | \$(631,000)            | \$(744,800) |
| Add: Total stock-based employee compensation expense as reported under intrinsic value method (APB No. 25) for all awards, net of related tax effects ..... | \$ 14,600   | \$ 16,500   | \$ —                   | \$ —                   | \$ —        |
| Deduct: Total stock-based compensation expense determined under fair value based method (SFAS No. 123) for all awards, net of related tax effects .....     | \$ 947,600  | \$ 516,000  | \$33,900               | \$ 40,900              | \$ 67,200   |
| Pro forma net income .....  | \$1,423,600 | \$(320,600) | \$50,900               | \$(671,900)            | \$(812,000) |
| Earnings per share:   |             |             |                        |                        |             |
| Basic as reported .....   | \$ .16      | \$ .03      | \$ .01                 | \$ (.24)               | \$ (.23)    |
| Diluted as reported .....   | \$ .14      | \$ .02      | \$ .01                 | \$ (.24)               | \$ (.23)    |
| Basic pro forma .....   | \$ .10      | \$ (.03)    | \$ .01                 | \$ (.26)               | \$ (.25)    |
| Diluted pro forma .....   | \$ .08      | \$ (.03)    | \$ .01                 | \$ (.26)               | \$ (.25)    |

**ANALEX CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**H. Long-Lived Assets**

In August 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 143, “Accounting for Asset Retirement Obligations” (“SFAS No. 143”). SFAS No. 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 143 is effective for financial statements issued for fiscal years beginning after June 15, 2002. The company does not anticipate that adoption of SFAS No. 143 will have a material impact, either positive or negative, on future results of operations or financial condition.

In September 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets” (“SFAS No. 144”). SFAS No. 144 addresses financial accounting and reporting for the impairment and disposal of long-lived assets, including intangible assets with finite lives. The effective date for the Company’s implementation of SFAS No. 144 was January 1, 2002.

**I. Reclassifications:**

Certain prior period amounts have been reclassified to conform to the 2002 presentation.

**J. Derivatives**

The Company utilizes an interest rate swap to manage interest rate exposure. The interest rate swap has been designated as a cash flow hedge, wherein the effective portion of the change in value of the derivative instrument, based on market pricing, is reported as a component of other comprehensive income (loss) and is reclassified into earnings as interest expense in the period when the hedged transaction affects earnings. The ineffective portion of the change in value of the derivative instrument, if any, is recognized in current earnings during the period of change. The interest rate swap is carried at fair value in other liabilities.

**3. Accounts receivable:**

The components of accounts receivable are as follows:

|  | <b>December 31,</b> |             |
|--|---------------------|-------------|
|  | <b>2002</b>         | <b>2001</b> |
| Trade accounts receivable:                     |                     |             |
| U.S. Government:                               |                     |             |
| Amounts billed .....                           | \$10,312,900        | \$5,252,000 |
| Recoverable costs and profits—not billed ..... | 2,609,200           | 2,337,600   |
| Total .....                                    | 12,922,100          | 7,589,600   |
| Commercial, state and local governments:       |                     |             |
| Amounts billed .....                           | 334,800             | 725,800     |
| Recoverable costs and profits—not billed ..... | 151,400             | 988,600     |
| Total .....                                    | 486,200             | 1,714,400   |
| Total accounts receivable .....                | 13,408,300          | 9,304,000   |
| Less: Allowance for doubtful accounts .....    | (852,200)           | (926,400)   |
| Total accounts receivable, net .....           | \$12,556,100        | \$8,377,600 |



**ANALEX CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The following table summarizes activity in the allowance for doubtful accounts:

|                         | <u>Calendar<br/>year 2002</u> | <u>Calendar<br/>year 2001</u> | <u>6 months<br/>12/31/00</u> | <u>Unaudited<br/>6 months<br/>12/31/99</u> | <u>Fiscal year<br/>2000</u> |
|-------------------------|-------------------------------|-------------------------------|------------------------------|--|-----------------------------|
| Beginning balance ..... | \$926,400                     | \$151,200                     | \$151,200                    | \$ 253,700                                 | \$ 253,700                  |
| Additions .....         | —                             | 775,200                       | —                            | —  | —                           |
| Write-offs .....        | (74,200)                      | —                             | —                            | (104,300)                                  | (102,500)                   |
| Ending Balance .....    | <u>\$852,200</u>              | <u>\$926,400</u>              | <u>\$151,200</u>             | <u>\$ 149,400</u>                          | <u>\$ 151,200</u>           |

Unbilled accounts receivable can be invoiced upon completion of contractual billing cycles, attaining certain milestones under fixed-price contracts, attaining a stipulated level of effort on cost-type contracts for government agencies, upon completion of federal government overhead audits and upon final approval of design plans for engineering services.

**4. Fixed assets:**

The components of fixed assets are as follows:

|   | <u>December 31,</u> |                   |
|---|---------------------|-------------------|
|   | <u>2002</u>         | <u>2001</u>       |
| Computer hardware and software .....                  | \$ 515,700          | \$ 747,400        |
| Leasehold improvements .....                          | 36,400              | 27,700            |
| Laboratory equipment .....                            | 141,400             | 141,400           |
| Office equipment .....                                | 125,000             | 150,800           |
| Total fixed assets .....                              | 818,500             | 1,067,300         |
| Less: Accumulated depreciation and amortization ..... | (601,800)           | (806,700)         |
| Total fixed assets, net .....                         | <u>\$ 216,700</u>   | <u>\$ 260,600</u> |

**5. Goodwill and Other Intangible Assets**

As discussed in Note 2, the Company adopted SFAS No. 142 in January 2002, which required the Company to stop amortizing goodwill and certain intangible assets with an indefinite useful life. Instead, SFAS No. 142 requires that goodwill and intangible assets deemed to have an indefinite life be reviewed for impairment upon adoption of SFAS No. 142 and annually, thereafter. The Company's goodwill balance was approximately \$15.5 million and \$15.6 million as of December 31, 2002 and 2001, respectively. The decrease of approximately \$0.1 million was due to final purchase accounting adjustments from the Analex acquisition. A valuation assessment was performed as of January 1, 2002 and no goodwill impairment was identified. The Company performed its first annual impairment test as of October 1, 2002 and concluded that the goodwill was not impaired.

**ANALEX CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The Company's results of operations prior to 2001 do not reflect the provisions of SFAS No. 142. A reconciliation of previously reported net income (loss) with the amounts adjusted for the exclusion of goodwill amortization net of related income tax effects is as follows:

|   | <u>2002</u> | <u>2001</u> | <u>Six Months<br/>Ended<br/>December 31,<br/>2000</u> | <u>Six Months<br/>Ended<br/>December 31,<br/>1999</u> | <u>2000</u> |
|---|-------------|-------------|---|---|-------------|
| Net income as reported . . . . .                        | \$2,356,600 | \$196,000   | \$ 84,800   | \$(631,000)   | \$(744,800) |
| Add back goodwill amortization, net of<br>tax . . . . . | \$ —        | \$337,000   | \$169,000   | \$ 171,900  | \$ 338,000  |
| Adjusted net income . . . . .                           | \$2,356,600 | \$533,000   | \$253,800   | \$(459,100)   | \$(406,800) |
| Basic earnings per share:                               |             |             |   |   |             |
| As reported . . . . .                                   | \$ .16      | \$ .03      | \$ .01  | \$ (.24)  | \$ (.23)    |
| Goodwill amortization, net of<br>tax . . . . .          | \$ —        | \$ .04      | \$ .03  | \$ .06  | \$ .10      |
| Adjusted basic earnings per<br>share . . . . .          | \$ .16      | \$ .07      | \$ .04  | \$ (.18)  | \$ (.13)    |
| Diluted earnings per share:                             |             |             |   |   |             |
| As reported . . . . .                                   | \$ .14      | \$ .02      | \$ .01  | \$ (.24)  | \$ (.23)    |
| Goodwill amortization, net of<br>tax . . . . .          | \$ —        | \$ .04      | \$ .02  | \$ .06  | \$ .10      |
| Adjusted basic earnings per<br>share . . . . .          | \$ .14      | \$ .06      | \$ .03  | \$ (.18)  | \$ (.13)    |

The gross carrying amounts and accumulated amortization of the Company's intangible assets as of December 31, 2002 and 2001, were as follows:

|                                  | <u>December 31, 2002</u>             |                                     | <u>December 31, 2001</u>             |                                     |
|----------------------------------|--------------------------------------|-------------------------------------|--------------------------------------|-------------------------------------|
|                                  | <u>Gross<br/>Carrying<br/>Amount</u> | <u>Accumulated<br/>Amortization</u> | <u>Gross<br/>Carrying<br/>Amount</u> | <u>Accumulated<br/>Amortization</u> |
| Non-compete agreements . . . . . | \$ 892,000                           | \$303,400                           | \$892,000                            | \$41,500                            |
| Contract rights . . . . .        | 1,053,200                            | 44,600                              | —                                    | —                                   |
| Patents . . . . .                | 153,200                              | —                                   | —                                    | —                                   |

Non-compete agreements are amortized on a straight-line basis over their contractual lives of three to four years. Contract rights are amortized over ten years, which is the life of the related contract. All patents are still pending approval, therefore, no amortization expense has been recorded. The weighted average life of all intangible assets is 5.2 years as of December 31, 2002. The estimated aggregate amortization expense for each of the five succeeding years is as follows:

|                |           |
|----------------|-----------|
| 2003 . . . . . | \$382,000 |
| 2004 . . . . . | 352,000   |
| 2005 . . . . . | 202,000   |
| 2006 . . . . . | 117,000   |
| 2007 . . . . . | 117,000   |

**ANALEX CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**6. Debt:**

The components of debt are as follows:

|                                 | December 31, |             |
|---------------------------------|--------------|-------------|
|                                 | 2002         | 2001        |
| Current:                        |              |             |
| Line of Credit .....            | \$2,187,700  | \$1,696,500 |
| Bank Term Note .....            | 700,000      | 700,000     |
| Convertible Notes .....         | —            | 101,700     |
| Notes Payable Shareholder ..... | 145,100      | 154,500     |
| Note Payable Other .....        | 333,300      | 100,000     |
| Non-compete Agreements .....    | 261,900      | 261,900     |
| Note to DOJ .....               | 260,500      | 207,300     |
| Other .....                     | 11,300       | 13,100      |
| Subtotal current debt .....     | 3,899,800    | 3,235,000   |
| Long-term:                      |              |             |
| Bank Term Note .....            | 2,041,700    | 2,741,600   |
| Notes Payable Shareholder ..... | 490,900      | 618,100     |
| Note Payable Other .....        | 583,300      | —           |
| Non-compete Agreements .....    | 534,700      | 616,600     |
| Note to DOJ .....               | 685,900      | 1,025,500   |
| Other .....                     | 2,400        | 2,400       |
| Subtotal long-term debt .....   | 4,338,900    | 5,004,200   |
| Total debt .....                | \$8,238,700  | \$8,239,200 |

On November 2, 2001, to finance the acquisition of Analex, the Company entered into a Credit Agreement (“Agreement”) with Bank of America, N.A. The Agreement provides the Company with a \$4,000,000 revolving credit facility (the “Credit Facility”) through November 2, 2006 and a five-year \$3,500,000 term loan (“Term Loan”). The Credit Facility has an annual renewal occurring April 30 of each year. The principal amount of the Term Loan is amortized in sixty equal monthly payments of \$58,333. Interest on each of the facilities is at the LIBOR Rate plus an applicable margin as specified in a pricing grid. The interest rate at December 31, 2002 was 3.92% for the Credit Facility and 4.38% for the Term Loan. The Company is subject to certain financial covenants pursuant to the Agreement, including debt to EBITDA ratio, fixed charge coverage ratio, senior debt to EBITDA ratio, and net worth requirements. The Company is in compliance with all financial covenants. The Credit Facility and Term Loan are secured by the accounts receivable and other assets of the Company.

To fund additional working capital requirements generated by the award of the ELVIS contract, the Company negotiated an increase of the Credit Facility. The Company now has an \$8,000,000 Credit Facility.

The Company’s \$3.5 million term loan facility from Bank of America carries interest comprised of two components: floating-rate LIBOR plus a credit performance margin. The Company has entered into an interest-rate swap agreement with Bank of America whereby its obligation to pay floating-rate LIBOR on debt totaling \$2,950,000 is swapped into a fixed rate obligation at 4.25% beginning in January 2002. The Company continues to have the obligation to pay the credit performance margin in addition to its swapped 4.25% payment obligation. The fair value of the swap of \$(90,600) is included in other liabilities.

In addition, the Company was required by Bank of America to obtain personal guarantees in the amount of \$2,000,000, which the Company procured from two individuals, the Company’s Board member Gerald R.

**ANALEX CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

McNichols and J. Richard Knop. The compensation during the period of guaranty is in the form of cash and warrants. On December 20, 2002, Mr. McNichols and Mr. Knop were released from the guarantees.

On November 2, 2001, the Company issued promissory notes to certain Analex sellers totaling \$772,600 with a five-year term, bearing interest at 6%. The Company also entered into non-competition agreements with these sellers for total payments of \$540,000 over a three-year period. In addition, the Company entered into non-competition agreements with former employees totaling \$352,000, on a discounted basis, payable over various periods.

On May 29, 2002, Analex announced that it had been awarded a \$164 million Expendable Launch Vehicle Integrated Support (“ELVIS”) prime contract by NASA. In conjunction with this award the Company issued promissory notes to certain Analex sellers totaling \$1,000,000 with a three-year term, bearing interest at prime plus 1%. At December 31, 2002, the outstanding balance on these notes was \$916,700.

With its purchase of Analex, the Company assumed a note payable to the Department of Justice (“DOJ”). The agreement provides for quarterly payments of \$80,000 consisting of principal and interest at 7% through February 2006, with a final payment due in May 2006.

In May 1999, the Company issued three-year \$998,000 convertible notes, interest payable at 6%, to the former shareholders of ATI in connection with the Company’s acquisition of ATI. The notes were convertible into 444,000 restricted shares of the Company’s Common Stock at \$2.25 per share. These notes were subordinated to the Company’s obligations under the Term Note and the Credit Facility. In May 2000, the Board of Directors adopted resolutions providing for the conversion of the convertible notes on the basis of one share of Common Stock for \$1.25 per share if tendered to Hadron for conversion before the close of business on June 30, 2000. At June 30, 2000, \$846,000 of the convertible notes were converted into 677,000 restricted shares of the Company’s Common Stock at the \$1.25 per share. As of December 31, 2001, two convertible notes totaling \$102,000 remained. As of December 31, 2002, these notes have been paid in full.

In connection with the December 1998 purchase of Vail Research and Technology Corporation (“Vail”), the Company issued two non-interest bearing promissory notes of \$300,000 and \$100,000, respectively. The \$300,000 non-interest bearing note was payable each month in the amount of \$25,000 for twelve months. The \$100,000 non-interest bearing promissory note was due and payable on the two-year anniversary of the closing date, less permitted deductions taken for contingent liabilities and uncollected accounts receivable. The Company took permitted deductions in the amount of \$70,000 and repaid the balance of the note payable in 2002.

The Company’s future debt maturities at December 31, 2002 are summarized below:

| <u>Year</u>                       | <u>Debt<br/>Maturities</u> |
|-----------------------------------|----------------------------|
| 2003 .....                        | 3,899,800                  |
| 2004 .....                        | 1,730,800                  |
| 2005 .....                        | 1,655,400                  |
| 2006 .....                        | 939,000                    |
| 2007 .....                        | <u>13,700</u>              |
| Total minimum debt payments ..... | 8,238,700                  |
| Less: current maturities .....    | <u>(3,899,800)</u>         |
| Total long-term debt .....        | <u>\$ 4,338,900</u>        |

**ANALEX CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**7. Equity capital:**

Pursuant to the November 2, 2001 acquisition of Analex, the Company issued 3,572,143 shares of the Company's Common Stock to the shareholders representing all of the outstanding equity of Analex (the "Sellers"). Of the 3,572,143 shares, 857,143 shares are subject to a provision by which the Company guarantees for a five-year period to reimburse the Sellers the difference between the price at which they sell such shares and a guaranteed sales price ranging from \$1.60 to \$2.20 per share ("Guaranteed Shares"), if such shares are sold within such period and if certain other conditions are satisfied.

As of December 31, 2002, the maximum amount that the Company would be required to pay under the terms of the guarantee was \$728,600. As the fair market value of the Company common stock was in excess of the guaranteed share prices as of December 31, 2002, no amounts were accrued under the guarantee.

To finance the acquisition of Analex, the Company issued 3,961,060 shares of common stock for aggregate consideration of approximately \$3,868,000 through a private placement consisting of (i) Hadron Common Stock at a price of \$1.14 per share to purchasers who purchased less than \$500,000 worth thereof or (ii) units consisting of Hadron Common Stock and warrants to purchase 0.2061 shares of Hadron Common Stock at an exercise price of \$0.02 per share for each share purchased at a price of \$1.14 per unit for purchasers who purchased \$500,000 or more of Hadron's equity. Two of such purchasers are directors or affiliates of a director. The warrants were exercised concurrent with the stock purchase.

On November 2, 2001, to assist in financing the Analex acquisition, Dr. C.W. Gilluly, one of the Company's directors, and J. Richard Knop, exercised warrants and/or stock options to purchase an aggregate of 247,888 shares of common stock, resulting in proceeds of approximately \$200,000.

On January 16, 2001, Sterling E. Phillips, Jr. was appointed to the positions of President and Chief Executive Officer of the Company. Mr. Phillips was also elected to serve as a member of the Company's Board of Directors. In connection with his appointment, Mr. Phillips purchased 66,667 shares of Common Stock for \$0.75 per share. As a result of this transaction, the Company recorded deferred compensation of \$10,800, \$5,400 of which was amortized during 2001, the remainder was amortized in 2002. In addition, Mr. Phillips was awarded a five-year, non-qualified stock option to purchase 875,725 shares of the Company's common stock at the exercise price equal to 100% of the fair market value of the common stock on the grant date, exercisable in one-third increments over a two-year period.

**8. Other current liabilities:**

Other current liabilities include the following major classifications:

|   | <u>December 31,</u> |                    |
|---|---------------------|--------------------|
|   | <u>2002</u>         | <u>2001</u>        |
| Payroll and related taxes . . . . .       | \$2,675,200         | \$2,599,900        |
| Accrued vacation . . . . .                | 1,138,000           | 1,162,700          |
| Self-insured medical expense . . . . .    | 640,500             | 88,300             |
| Due to subcontractors . . . . .           | 30,700              | 175,000            |
| Deferred income . . . . .                 | —                   | 434,500            |
| Other . . . . .                           | 774,000             | 319,000            |
| Total other current liabilities . . . . . | <u>\$5,258,400</u>  | <u>\$4,779,400</u> |

**ANALEX CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**9. Acquisitions:**

Effective November 2001, the Company acquired Analex, a professional services and program management firm whose principal customers are NASA and the U.S. intelligence community, for approximately \$13,898,000. The purchase price was satisfied with cash payments of \$6,510,000, 3,520,339 shares of Common Stock valued at \$4,664,000, the issuance of promissory notes of \$1,773,000, non-compete arrangements of \$892,000, and the satisfaction of other certain liabilities of Analex.

The fair value of the assets acquired and liabilities assumed approximated their book value of \$6,092,400 and \$5,730,000, respectively. The Company incurred financial, legal and accounting costs associated with the Analex purchase of approximately \$570,000. During 2002, certain contingencies were finalized including the settlement of the Analex closing balance sheet requirements and the award of the ELVIS contract.

Following is a condensed balance sheet reflecting the final purchase price allocation:

|  |            |
|--|------------|
| Cash .....   | \$ 343,100 |
| Accounts receivable and other current assets ..... | 3,713,800  |
| Non-compete agreements .....                       | 892,000    |
| Contract rights .....                              | 1,053,200  |
| Goodwill .....                                     | 14,061,700 |
| Other long term assets .....                       | 90,300     |
| Current liabilities .....                          | 4,357,500  |
| Long term debt and other liabilities .....         | 1,372,500  |

Goodwill related to the acquisition of Analex in November 2001 is subject to SFAS 142, and accordingly has not been amortized. Other intangible assets identified in connection with the acquisition, including non-compete arrangements and contractual relationships, are amortized on a straight-line basis over their estimated lives ranging from three to ten years.

The weighted-average amortization life of contract rights and other intangibles is 5.2 years. Amortization expense for contract rights and other intangibles for the fiscal years ended 2002 and 2001 was \$307,600 and \$41,700. Amortization expense for goodwill for the year ended December 31, 2001, the six month periods ended December 31, 2000 and December 31, 1999, and the fiscal year ended June 30, 2000 was \$336,700, \$162,000, \$172,000, and \$344,000.

The following table sets forth adjusted pro forma results of operations of the Company for 2001, the six month period ended December 31, 2000 and the fiscal year 2000, as if Analex had been acquired at the beginning of the respective periods.

|                              | <u>2001</u>  | <u>Six months<br/>ended<br/>December 31,<br/>2000<br/>(unaudited)</u> | <u>Fiscal Year<br/>2000</u> |
|------------------------------|--------------|---|-----------------------------|
| Net revenues .....           | \$49,126,600 | \$24,772,400  | \$49,733,300                |
| Net income (loss) .....      | \$ 910,200   | \$ 1,242,100  | \$ (650,500)                |
| Net income (loss) per share: |              |   |                             |
| Basic EPS .....              | \$ .06       | \$ .09  | \$ (.06)                    |
| Diluted EPS .....            | \$ .05       | \$ .08  | \$ (.06)                    |

On May 12, 1999, the Company acquired all the outstanding capital stock of ATI, a privately held information technology firm based in Alexandria, Virginia, for \$2,503,000. Resulting from the acquisition of ATI, the Company recorded goodwill of approximately \$2,287,000, which, until the implementation of SFAS 142, was being amortized, on a straight-line basis, over a 7-year period.

**ANALEX CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**10. Net income (loss) per share:**

The following table sets forth the computation of basic and diluted earnings per share:

|   | <u>2002</u>       | <u>2001</u>      | <u>6 mos<br/>12/31/00</u> | <u>Unaudited<br/>6 mos<br/>12/31/99</u> | <u>Fiscal<br/>2000</u> |
|---|-------------------|------------------|---------------------------|---|------------------------|
| Numerator:  |                   |                  |                           |   |                        |
| Net income (loss) . . . . .                             | \$ 2,356,900      | \$ 196,000       | \$ 84,800                 | \$ (631,000)                            | \$ (744,800)           |
| Denominator:  |                   |                  |                           |   |                        |
| Denominator for basic earnings per<br>share:            |                   |                  |                           |   |                        |
| Weighted average shares outstanding . . . . .           | 14,412,554        | 7,721,779        | 6,153,914                 | 2,599,915                               | 3,276,269              |
| Effect of dilutive securities:                          |                   |                  |                           |   |                        |
| Warrants . . . . .                                      | 1,860,811         | 1,413,289        | 892,288                   | —                                       | —                      |
| Employee stock options . . . . .                        | 808,286           | 452,961          | 72,693                    | —                                       | —                      |
| Denominator for diluted earnings per<br>share . . . . . | <u>17,081,651</u> | <u>9,588,029</u> | <u>7,118,895</u>          | <u>2,599,915</u>                        | <u>3,276,269</u>       |
| Basic earnings per share . . . . .                      | <u>\$ .16</u>     | <u>\$ .03</u>    | <u>\$ .01</u>             | <u>\$ (.24)</u>                         | <u>\$ (.23)</u>        |
| Diluted earnings per share . . . . .                    | <u>\$ .14</u>     | <u>\$ .02</u>    | <u>\$ .01</u>             | <u>\$ (.24)</u>                         | <u>\$ (.23)</u>        |

Shares issuable upon the exercise of stock options or warrants or upon conversion of debt have been excluded from the computation to the extent that their inclusion would be anti-dilutive.

**11. Income taxes:**

The provision for income taxes for 2002, 2001, the six month periods ended December 31, 2000 and 1999, and the fiscal year 2000 has been limited to state taxes and the liability for alternative minimum tax as the majority of income for federal and state tax purposes has been offset by carrying forward net operating losses.

The tax provision differs from the amounts computed using the statutory federal income tax rate as follows:

|  | <u>2002</u> | <u>2001</u>  | <u>6 mos<br/>12/00</u> | <u>6 mos<br/>12/99</u> | <u>FY<br/>2000</u> |
|--|-------------|--------------|------------------------|------------------------|--------------------|
| Tax expense at statutory rate-federal . . . . .            | 35%         | 35%          | 35%                    | (35)%                  | (35)%              |
| State tax expense net of federal taxes . . . . .           | 4           | 13           | 3                      | 1                      | 1                  |
| Permanent differences . . . . .                            | 3           | 63           | 158                    | 17                     | 17                 |
| Utilization of net operating loss carry forwards . . . . . | <u>(36)</u> | <u>(102)</u> | <u>(196)</u>           | <u>17</u>              | <u>20</u>          |
| Tax expense at actual rate . . . . .                       | <u>6%</u>   | <u>9%</u>    | <u>0%</u>              | <u>0%</u>              | <u>3%</u>          |

**ANALEX CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting and income tax purposes. Deferred tax assets at December 31, 2002 and 2001 consist primarily of the following:

|                                       | <b>December<br/>2002</b> | <b>December<br/>2001</b> |
|---------------------------------------|--------------------------|--------------------------|
| Net operating loss carryforward ..... | \$ 826,100               | \$ 1,933,900             |
| Reserve for bad debts .....           | 328,700                  | 58,300                   |
| Accrued vacation .....                | 378,900                  | 448,500                  |
| Fixed assets .....                    | 21,200                   | 0                        |
| Unbilled receivables .....            | (789,800)                | (1,012,700)              |
| Other .....                           | 5,600                    | (68,900)                 |
| Valuation allowance .....             | (770,700)                | (1,359,100)              |
| Net deferred tax asset .....          | \$ —                     | \$ —                     |

At December 31, 2002, the Company had net operating loss carryforwards for federal income tax purposes of approximately \$2,141,400, which expire at various dates beginning June 30, 2008. The Company's utilization of these carryforwards may be subject to limitation under Section 382 of the Internal Revenue Code.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some or all of the deferred tax asset will not be realized. The ultimate realization of the deferred tax asset is dependent upon the generation of future taxable income during the periods in which the net operating loss carryforwards are available. Management considers projected future taxable income, the scheduled reversal of deferred tax liabilities and available tax planning strategies that can be implemented by the Company in making this assessment. Based upon the level of historical taxable income and projection for future taxable income over the periods in which the net operating loss carryforwards are available to reduce income taxes payable, management has established a full valuation allowance.

**12. Commitments and contingencies:**

*Operating leases:*

The Company leases real property and personal property under various long-term operating leases and sublease agreements expiring at various dates through 2006. Certain of the leases contain renewal options and require payment of property taxes, insurance and maintenance costs. The Company's future minimum operating lease commitments inclusive of property taxes, insurance and maintenance costs at December 31, 2002 are summarized below:

| <b>Year</b>                           | <b>Lease<br/>Commitments</b> |
|---------------------------------------|------------------------------|
| 2003 .....                            | 1,122,000                    |
| 2004 .....                            | 1,037,600                    |
| 2005 .....                            | 774,200                      |
| 2006 .....                            | 56,200                       |
| Total minimum payments required ..... | \$2,990,000                  |



**ANALEX CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

Rent expense, net of sublease income, included in the consolidated statements of operations is as follows:

| <u>Period</u>                   | <u>Rent<br/>Expense</u> |
|---------------------------------|-------------------------|
| 2002 .....                      | \$1,143,100             |
| 2001 .....                      | 572,900                 |
| 6 Months 2000 .....             | 247,500                 |
| 6 Months 1999 (unaudited) ..... | 272,100                 |
| Fiscal Year 2000 .....          | 530,300                 |

*U.S. government contract audits:*

The Company's revenues and costs related to contracts with agencies and departments of the U.S. government are subject to audit by the Defense Contract Audit Agency, which has completed the majority of its audits for the Company's fiscal years through fiscal year 2000. It is the opinion of management that the results of such audits will not have a material effect on the financial condition or results of operations of the Company.

**13. Benefit plans:**

*Employee savings plan:*

The Company sponsors a defined contribution savings plan under section 401(k) of the Internal Revenue Code. The Company's contributions to the 401(k) plan are based upon a percentage of employee contributions. The Company's discretionary contributions to the Plan were \$1,067,200, \$432,000, \$79,000, \$69,000, and \$150,000 for 2002, 2001, the six month periods ended December 31, 2000 and 1999 (unaudited), and the fiscal year 2000 respectively.

*Employee stock purchase plan:*

In December 1997, shareholders approved the Hadron, Inc. 1997 Employee Stock Purchase Plan (the "Plan"). In fiscal year 2000 and the six-month period ended December 31, 2000, amendments to the Plan were adopted to increase the number of shares reserved for issuance thereunder from 250,000 to 500,000. The purpose of the Plan is to secure for the Company and its shareholders the benefits of the incentive inherent in the ownership of Common Stock by present and future employees of the Company. The Plan is intended to comply with the terms of Section 423 of the Internal Revenue Code of 1986, as amended, and Rule 16b-3 of the Securities Exchange Act of 1934. The Plan is non-compensatory as defined by APB 25. Under the terms of the Plan, individual employees may pay up to \$10,000 for the purchase of the Company's common shares, at 85% of the determined market price. During 2002, 2001, the six month periods ended December 31, 2000 and 1999 (unaudited), and the fiscal year 2000, employees paid approximately \$141,000, \$41,000, \$14,000, \$37,000, and \$50,000, respectively, for the purchase of common stock under the Plan.

*Employee deferred compensation plan:*

In December 1998, shareholders approved the Hadron, Inc. Deferred Compensation Plan (the "Plan"). The Plan is intended to provide employees an option to defer a portion of their salary in order to provide for supplemental retirement benefits. As a requirement of this non-qualified plan, participant deferrals remain as unsecured liabilities of the Company. Under the terms of the Plan, eligible employees can elect to irrevocably defer salary of up to \$50,000 for the calendar year. If an employee elects to defer at least one and one-half percent of his/her gross salary, the Company contributes one-half percent of the participant's gross salary to the participant's supplemental account. Salary deferrals and Company contributions earn interest at the higher of six

## ANALEX CORPORATION

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

percent or the rate quoted for ninety-day Treasury Bills. During 2002, 2001, the six month periods ended December 31, 2000 and 1999 (unaudited), and the fiscal year 2000, employees deferred approximately \$8,700, \$10,700, \$2,000, \$54,000, and \$81,000, respectively, of which the Company matched approximately \$1,200, \$3,000, \$500, \$3,000, and \$4,000 during these periods.

*Other:*

Pursuant to the acquisition of Analex, the Company assumed the Analex Corporation Employee Stock Ownership Plan and Trust (the “Analex ESOP”). The Analex ESOP was terminated as of the November 5, 2001, the effective date of the acquisition. The Company has obtained a determination letter from the Internal Revenue Service and is in the process of liquidating the Analex ESOP.

*Collective Bargaining Agreement:*

The company has two collective bargaining agreements (“CBA”). The CBA with the International Brotherhood of Electrical Workers expires January 31, 2006, and covers 11 employees at John F. Kennedy Space Center, Florida, and Cape Canaveral Air Force Station, Florida. The CBA with the Teamsters and Warehousemen Union covers 35 employees at Vandenberg Air Force Base and expires October 31, 2005.

**ANALEX CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**14. Stock option plan:**

In December 2000, shareholders approved the Hadron, Inc. 2000 Stock Option Plan (“2000 Stock Option Plan”). The 2000 Stock Option Plan provides for the issuance of incentive stock options within the meaning of Section 422 of the Internal Revenue Code of 1986 and non-qualified stock options to purchase an aggregate of up to 600,000 shares of Common Stock. The 2000 Stock Option Plan permits the grant of options to key employees, consultants and directors of the Company. The exercise price of the incentive stock options is required to be at least equal to 100% of the fair market value of the Company’s common stock on the date of grant (110% of the fair market value in the case of options granted to employees who are 10% shareholders). The exercise price of the non-qualified stock options is required to be not less than the par value of a share of the Company’s common stock on the date of grant. The term of an incentive or non-qualified stock option may not exceed ten years (five years in the case of an incentive stock option granted to a 10% shareholder). The vesting for each option holder is set forth in the individual option agreements and is generally a three year period. The 2000 Stock Option Plan honors all of the stock options outstanding under the Company’s 1994 Stock Option Plan, as amended (the “Plan”).

Information with respect to incentive and non-qualified stock options issued under both plans are as follows:

|                             | 2002      |  | 2001      |  | 6 mos. 12/31/00 |  | Unaudited<br>6 mos. 12/31/99 |  | Fiscal 2000 |  |
|-----------------------------|-----------|--|-----------|--|-----------------|--|------------------------------|--|-------------|--|
|                             | Shares    | Weighted<br>Average<br>Exercise<br>Price | Shares    | Weighted<br>Average<br>Exercise<br>Price | Shares          | Weighted<br>Average<br>Exercise<br>Price | Shares                       | Weighted<br>Average<br>Exercise<br>Price | Shares      | Weighted<br>Average<br>Exercise<br>Price |
| Outstanding at beginning    |           |  |           |  |                 |  |                              |  |             |  |
| of period . . . . .         | 1,672,500 | \$1.20                                   | 479,300   | \$ .98                                   | 395,400         | \$ .94                                   | 514,400                      | \$.90                                    | 514,400     | \$.90                                    |
| Granted . . . . .           | 813,100   | 2.20                                     | 1,292,800 | 1.29                                     | 204,500         | 1.04                                     | 109,500                      | .81                                      | 129,500     | .91                                      |
| Exercised . . . . .         | (21,200)  | .90                                      | (64,300)  | 1.31                                     | (62,500)        | .42                                      | (15,000)                     | .25                                      | (78,200)    | .37                                      |
| Expired . . . . .           | (8,300)   | 1.60                                     | (35,300)  | 1.01                                     | (58,100)        | 1.47                                     | (32,900)                     | .94                                      | (170,300)   | 1.10                                     |
| Outstanding at end of       |           |  |           |  |                 |  |                              |  |             |  |
| period . . . . .            | 2,456,100 | \$1.55                                   | 1,672,500 | \$1.20                                   | 479,300         | \$ .98                                   | 576,000                      | \$.90                                    | 395,400     | \$.94                                    |
| Options exercisable at end  |           |  |           |  |                 |  |                              |  |             |  |
| of period . . . . .         | 1,485,100 | \$1.38                                   | 743,300   | \$1.12                                   | 301,800         | \$ .96                                   | 494,700                      | \$.83                                    | 304,100     | \$.75                                    |
| Weighted average fair       |           |  |           |  |                 |  |                              |  |             |  |
| value of options granted    |           |  |           |  |                 |  |                              |  |             |  |
| during the period . . . . . | \$ 1.58   |  | \$ 1.24   |  | \$ .95          |  | \$ .48                       |  | \$ .42      |  |

The weighted average remaining contractual life of options outstanding at December 31, 2002 was 6.1 years. The range of exercise prices of options outstanding at December 31, 2002 was \$.25 to \$2.25.

The following table summarizes information about the stock options outstanding at December 31, 2002:

| Exercise Price | Outstanding      |                                 |   | Exercisable      |                                 |
|----------------|------------------|---------------------------------|---|------------------|---------------------------------|
|                | Number of Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Life (years) | Number of Shares | Weighted-Average Exercise Price |
| 0.25 – 0.75    | 92,500           | \$0.43                          | 2.53  | 92,500           | \$0.43                          |
| 0.76 – 1.30    | 597,000          | 1.07                            | 8.14  | 475,000          | 1.06                            |
| 1.31 – 2.25    | 1,766,600        | 1.77                            | 6.00  | 917,600          | 1.64                            |
|                | <u>2,456,100</u> |                                 |   | <u>1,485,100</u> |                                 |

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing fair value model. The following assumptions were used for grants: dividend yield of 0%; expected volatility of .6 to 1.115; expected life of the option term of 10 years and risk-free interest rate of 3.71 to 5.17%.

**ANALEX CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**15. Warrants:**

The Company has issued warrants to certain parties to purchase its Common Stock in connection with certain debt and equity transactions. The range of exercise prices for warrants outstanding at December 31, 2002 was \$.02 to \$.75.

Information with respect to warrants issued is as follows:

|                       | <u>2002</u>      |              | <u>2001</u>      |              | <u>6 months</u>  |              | <u>Unaudited</u> |              | <u>Fiscal</u>    |              |
|-----------------------|------------------|--------------|------------------|--------------|------------------|--------------|------------------|--------------|------------------|--------------|
|                       | <u>Warrants</u>  | <u>Price</u> | <u>Warrants</u>  | <u>Price</u> | <u>12/31/00</u>  | <u>Price</u> | <u>6 months</u>  | <u>Price</u> | <u>2000</u>      | <u>Price</u> |
|                       |                  |              |                  |              | <u>Warrants</u>  |              | <u>12/31/99</u>  |              | <u>Warrants</u>  |              |
| Outstanding at        |                  |              |                  |              |                  |              |                  |              |                  |              |
| beginning of period   | 2,277,300        |              | 2,467,100        |              | 2,855,000        |              | 620,000          |              | 620,000          |              |
| Granted .....         | 198,500          | \$0.02       | 31,100           | \$0.02       | 75,000           | \$0.75       | —                |              | 2,455,000        | \$0.72       |
| Exercised .....       |                  |              | (220,900)        | 0.72         | (462,900)        | 0.72         | (220,000)        | \$0.25       | (220,000)        | 0.25         |
| Expired .....         | —                |              | —                |              | —                |              | —                |              | —                |              |
| Outstanding at end of |                  |              |                  |              |                  |              |                  |              |                  |              |
| period .....          | <u>2,475,800</u> |              | <u>2,277,300</u> |              | <u>2,467,100</u> |              | <u>400,000</u>   |              | <u>2,855,000</u> |              |

**16. Voting Agreement:**

On March 30, 2000, a group of investors led by Jon M. Stout, Patricia W. Stout, the Stout Dynastic Trust (collectively the “Stouts”), J. Richard Knop (“Knop”) (the Stouts and Knop, being collectively the “Investors”) and John D. Sanders purchased certain of the Company’s securities pursuant to a Securities Purchase Agreement among the Company and the Investors (the “Purchase Agreement”).

As further required by the Purchase Agreement, the Investors and others designated therein also entered into a Voting Agreement dated March 30, 2000 (the “Voting Agreement”). The Voting Agreement was entered into by and among certain affiliates of Boles Knop & Company, L.L.C. (the “Affiliates”), Dr. Sanders, C.W. Gilluly and the Investors (collectively, the “Voting Group”). Effective November 1, 2002, Dr. Sanders was removed from the Voting Agreement.

The Voting Group agreed, for a period of five (5) years from March 30, 2000, to vote all of the voting shares over which they have voting control and to take all other actions within such Voting Group’s control (whether in his or its capacity as a stockholder, director, member of a board committee or officer of the Company or otherwise), including, without limitation, attendance at meetings in person or by proxy for purposes of obtaining a quorum and execution of written consents in lieu of meetings so that: (1) The authorized number of members of the Board will continue to be five unless and until such greater number is directed or approved by the Investors; (2) During the term of the Voting Agreement, the Investors shall be entitled to nominate a majority of the members of the Board (the “Nominees”) and the Stockholders shall vote their shares to elect such Nominees; (3) Any Nominee elected or appointed as a director will be removed from the Board (and thereupon from all committees of the Board), with or without cause, only upon the written request or consent of the Investors; (4) In the event that any Nominee designated hereunder for any reason ceases to serve as a member of the Board or any committee thereof during such representative’s term of office, the resulting vacancy on the Board or committee will be filled by a newly designated Nominee; and (5) Upon the written direction or consent of the Investors, the Company will take such actions as may be necessary and convenient to change the corporate domicile of the Company to the state of Delaware.

In addition, the Voting Agreement provides that with the exception of transfers made: (i) pursuant to open market sales in brokers’ transactions; or (ii) sales made after the Investors declined a right of first refusal to

## ANALEX CORPORATION

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

purchase such shares at the same price and terms, any attempt to transfer the Voting Group's voting shares will be of no effect unless the person(s) to whom such shares are being transferred agrees in writing to be bound by the terms of the Voting Agreement.

#### **17. Fair value of financial instruments:**

Accounts receivable, accounts payable, accrued expenses and other current assets and liabilities are carried at amounts which reasonably approximate their fair value. The estimated fair value of the Company's variable rate debt approximates its carrying value of \$2,579,400. It is not practicable to estimate the fair value of the Company's notes payable to related parties due to their unique nature.

#### **18. Statement of cash flows—supplemental disclosures:**

During 2002, 2001, the six month periods ended December 31, 2000 and 1999 (unaudited), and the fiscal year 2000, the Company paid income taxes of \$208,300, \$23,000, \$12,000, \$3,000, and \$4,000, respectively. The Company paid interest of \$672,900, \$165,000, \$110,000, \$167,000, and \$325,000 during those same periods.

#### **19. Business segments and major customers:**

##### *Business segments:*

The Company has two active reportable segments, ABS and Analex. The Homeland Security Group, and the Systems Engineering Group have been aggregated to form the reportable segment Analex. This aggregation is due to the fact that both groups perform similar services, operate in similar regulatory environments, and have similar customers. Each of the operating segments provides engineering, information technology, medical research or technical services to federal government agencies or major defense contractors. The reportable segments are distinguished by their individual clients, prior experience and technical skills.

Operating results are measured at the net income/(loss) level for each segment. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies. Interest on debt incurred in connection with an acquisition and applicable associated intangible amortization is charged to the reportable segment.

**ANALEX CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Reportable Segments—FASB Statement 131**

**For the Years ended December 31 2002, 2001, the Six Months ended December 31, 2000 and 1999  
(unaudited) and the Fiscal Year ended June 30, 2000**

| <u>Description:</u>                                  | <u>2002</u>         | <u>2001</u>         | <u>6 mos 2000</u>  | <u>Unaudited<br/>6 mos 1999</u> | <u>Fiscal 2000</u>  |
|--|---------------------|---------------------|--------------------|---------------------------------|---------------------|
| Trade revenues:                                      |                     |                     |                    |                                 |                     |
| ABS .....  | \$ 6,803,000        | \$ 4,761,300        | \$1,880,600        | \$ —                            | \$ 522,800          |
| Analex .....   | 52,514,000          | 17,174,700          | 7,062,800          | 10,267,300                      | 19,378,500          |
| Total trade revenues .....                           | <u>\$59,317,000</u> | <u>\$21,936,000</u> | <u>\$8,943,400</u> | <u>\$10,267,300</u>             | <u>\$19,901,300</u> |
| Interest income:                                     |                     |                     |                    |                                 |                     |
| ABS .....  | \$ —                | \$ —                | \$ —               | \$ —                            | \$ —                |
| Analex .....   | —                   | 8,600               | —                  | 600                             | 8,100               |
| Total interest income .....                          | <u>\$ —</u>         | <u>\$ 8,600</u>     | <u>\$ —</u>        | <u>\$ 600</u>                   | <u>\$ 8,100</u>     |
| Interest expense:                                    |                     |                     |                    |                                 |                     |
| ABS .....  | \$ —                | \$ —                | \$ —               | \$ —                            | \$ —                |
| Analex .....   | 1,018,300           | 225,200             | 112,000            | 167,100                         | 332,600             |
| Total interest expense .....                         | <u>\$ 1,018,300</u> | <u>\$ 225,200</u>   | <u>\$ 112,000</u>  | <u>\$ 167,100</u>               | <u>\$ 332,600</u>   |
| Depreciation and amortization expense:               |                     |                     |                    |                                 |                     |
| ABS .....  | \$ 31,000           | \$ 47,300           | \$ 10,600          | \$ —                            | \$ —                |
| Analex .....   | 388,000             | 476,900             | 218,900            | 208,700                         | 457,300             |
| Total depreciation and amortization<br>expense ..... | <u>\$ 419,000</u>   | <u>\$ 524,200</u>   | <u>\$ 229,500</u>  | <u>\$ 208,700</u>               | <u>\$ 457,300</u>   |
| Income tax expense:                                  |                     |                     |                    |                                 |                     |
| ABS .....  | \$ —                | \$ —                | \$ —               | \$ —                            | \$ —                |
| Analex .....   | 149,100             | 19,600              | —                  | —                               | 21,300              |
| Total income tax expense .....                       | <u>\$ 149,100</u>   | <u>\$ 19,600</u>    | <u>\$ —</u>        | <u>\$ —</u>                     | <u>\$ 21,300</u>    |
| Net income/(loss):                                   |                     |                     |                    |                                 |                     |
| ABS .....  | \$ 365,200          | \$ 186,200          | \$ 4,300           | \$ —                            | \$ (158,200)        |
| Analex .....   | 1,991,400           | 9,800               | 80,500             | (631,000)                       | (586,600)           |
| Total net income/(loss) .....                        | <u>\$ 2,356,600</u> | <u>\$ 196,000</u>   | <u>\$ 84,800</u>   | <u>\$ (631,000)</u>             | <u>\$ (744,800)</u> |
| Assets:  |                     |                     |                    |                                 |                     |
| ABS .....  | \$ 1,920,800        | \$ 1,017,200        | \$ 335,900         | \$ —                            | \$ 387,200          |
| Analex .....   | 28,863,400          | 24,607,900          | 5,448,000          | 6,127,200                       | 5,563,900           |
| Total assets .....                                   | <u>\$30,784,200</u> | <u>\$25,625,100</u> | <u>\$5,783,900</u> | <u>\$ 6,127,200</u>             | <u>\$ 5,951,100</u> |
| Fixed assets, net:                                   |                     |                     |                    |                                 |                     |
| ABS .....  | \$ 83,600           | \$ 116,400          | \$ 126,200         | \$ —                            | \$ 15,700           |
| Analex .....   | 133,100             | 144,200             | 158,600            | 256,600                         | 203,400             |
| Total fixed assets, net .....                        | <u>\$ 216,700</u>   | <u>\$ 260,600</u>   | <u>\$ 284,800</u>  | <u>\$ 256,600</u>               | <u>\$ 219,100</u>   |

**ANALEX CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

*Major Customers:*

Gross revenue from contracts and subcontracts with U.S. government agencies amounted to \$58,059,000, \$21,885,000, \$8,868,000, \$10,160,000 and \$19,684,000, respectively, in 2002, 2001, the six months ended December 31, 2000 and 1999 (unaudited), and the fiscal year 2000.

Revenues earned on sales to the Company's major customers are as follows:

| <u>Period</u>                   | <u>Department<br/>of Defense</u> |
|---------------------------------|----------------------------------|
| 2002 .....                      | 30,668,000                       |
| 2001 .....                      | 14,019,000                       |
| 6 Months 2000 .....             | 6,240,000                        |
| 6 Months 1999 (unaudited) ..... | 7,791,000                        |
| Fiscal Year 2000 .....          | 18,323,000                       |

**20. Selected quarterly information (Unaudited):**

The following is a summary of the quarterly results of operations for the years 2002 and 2001:

|   | <u>Quarter Ended:</u>        |                               |                          |                           |
|---|------------------------------|-------------------------------|--------------------------|---------------------------|
|   | <u>December 31,<br/>2002</u> | <u>September 30,<br/>2002</u> | <u>June 30,<br/>2002</u> | <u>March 31,<br/>2002</u> |
| Revenues .....                                      | \$17,034,700                 | \$16,318,600                  | \$12,928,200             | \$13,035,500              |
| Operating Income .....                              | 1,207,600                    | 1,193,300                     | 450,000                  | 673,100                   |
| Net Income .....                                    | 843,000                      | 914,000                       | 204,400                  | 395,200                   |
| Net Income per share, basic .....                   | \$ 0.06                      | \$ 0.06                       | \$ 0.01                  | \$ 0.03                   |
| Shares used in per share calculation, basic .....   | 14,221,237                   | 14,238,707                    | 14,395,177               | 14,385,725                |
| Net Income per share, diluted .....                 | \$ 0.05                      | \$ 0.05                       | \$ 0.01                  | \$ 0.02                   |
| Shares used in per share calculation, diluted ..... | 17,077,120                   | 17,013,845                    | 16,997,139               | 16,796,764                |

  

|   | <u>Quarter Ended:</u>        |                               |                          |                           |
|---|------------------------------|-------------------------------|--------------------------|---------------------------|
|   | <u>December 31,<br/>2001</u> | <u>September 30,<br/>2001</u> | <u>June 30,<br/>2001</u> | <u>March 31,<br/>2001</u> |
| Revenues .....                                      | \$ 9,211,200                 | \$4,137,300                   | \$4,357,600              | \$4,229,900               |
| Operating Income .....                              | 139,600                      | 124,200                       | 106,500                  | 83,700                    |
| Net Income .....                                    | 48,200                       | 54,100                        | 72,400                   | 23,300                    |
| Net Income per share, basic .....                   | \$ 0.004                     | \$ 0.01                       | \$ 0.01                  | \$ 0.003                  |
| Shares used in per share calculation, basic .....   | 11,284,468                   | 6,536,276                     | 6,517,780                | 6,505,728                 |
| Net Income per share, diluted .....                 | \$ 0.003                     | \$ 0.01                       | \$ 0.01                  | \$ 0.003                  |
| Shares used in per share calculation, diluted ..... | 13,922,965                   | 8,186,996                     | 7,985,845                | 7,731,937                 |