

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-QSB

(Mark One)

X Quarterly Report Under Section 13 or 15(d) of The Securities Exchange Act of 1934

For the quarterly period ended September 28, 2002

 Transaction Report Under Section 13 or 15(d) of the Securities Exchange Act

For the transition period from _____ to _____

Commission File Number 000-04169

SYS

(Exact Name of Small Business Issuer as Specified in Its Charter)

California

(State or Other Jurisdiction of
Incorporation or Organization)

95-2467354

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

9620 Chesapeake Drive, Suite 201, San Diego, California 92123

(Address of Principal Executive Offices)

(858) 715-5500

(Issuer's Telephone Number, Including Area Code)

(Former Name, Former Address and Former Fiscal Year, if Changed
Since Last Report)

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 4,970,813 shares of common stock, without par value, as of October 22, 2002.

Transitional Small Business Disclosure Format (check one):

Yes No X

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PART I
FINANCIAL INFORMATION

Item 1. Financial Statements

SYS AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEET

	September 28, 2002
	(Unaudited)
ASSETS	
Current assets:	
Cash	\$ 153,000
Contract receivables, net of allowance for doubtful accounts of \$26,000	5,173,000
Receivable from related party	5,000
Deferred tax assets	270,000
Income tax refund receivable	196,000
Other current assets	177,000
Total current assets	5,974,000
Furniture and equipment, less accumulated depreciation and amortization of \$902,000	768,000
Capitalized software for internal use, net of accumulated amortization of \$2,000	101,000
Goodwill	84,000
Other assets	190,000
	<u>\$ 7,117,000</u>
LIABILITIES & STOCKHOLDERS' EQUITY	
Current liabilities:	
Borrowings under bank line of credit	\$ 289,000
Current portion of working capital loan	181,000
Accounts payable	611,000
Accrued payroll and related taxes	1,167,000
Other accrued liabilities	113,000
Current portion of related party note payable	8,000
Current portion of capital lease obligations	41,000
Total current liabilities	2,410,000
Working capital loan, net of current portion	236,000
Convertible notes payable	450,000
Convertible notes payable to related parties	550,000
Capital lease obligations, net of current portion	92,000
Deferred tax liabilities	147,000
Total liabilities	<u>3,885,000</u>

Stockholders' equity:

9% preference stock, \$1.00 par value; 2,000,000 shares authorized; 69,781 Series B shares issued and outstanding	70,000
Common stock, no par value; 48,000,000 shares authorized; 4,970,813 shares issued and outstanding	2,152,000
Common stock subscriptions receivable from company officers for 90,000 shares	(64,000)
Retained earnings	1,074,000
	<hr/>
Total stockholders' equity	3,232,000
	<hr/>
	\$ 7,117,000
	<hr/>

SYS AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three months ended	
	September 28, 2002	September 29, 2001
Contract revenues	\$ 5,248,000	\$ 3,534,000
Costs and expenses:		
Contract costs	4,353,000	2,987,000
General and administrative expenses	739,000	355,000
Totals	5,092,000	3,342,000
Income from operations	156,000	192,000
Other (income) expenses:		
Interest income	(1,000)	(1,000)
Interest expense	53,000	35,000
Gain on sale and disposition of equipment	0	(5,000)
Totals	52,000	29,000
Income before income taxes	104,000	163,000
Provision for income taxes	42,000	63,000
Net income	62,000	100,000
Preference dividend requirements	3,000	3,000
Net income applicable to common stock	\$ 59,000	\$ 97,000
Basic net income per common share	\$ 0.01	\$ 0.03
Diluted net income per common share	\$ 0.01	\$ 0.03

SYS AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three months ended	
	September 28, 2002	September 29, 2001
Operating activities:		
Net income	\$ 62,000	\$ 100,000
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	74,000	47,000
Gain on sale and disposition of equipment		(5,000)
Accretion of debt discount	16,000	
Changes in operating assets and liabilities:		
Contract receivables	(726,000)	(501,000)
Other receivables	17,000	25,000
Other current assets	(111,000)	(30,000)
Other assets	(93,000)	(17,000)
Accounts payable	69,000	196,000
Accrued payroll and related taxes	416,000	309,000
Income taxes payable		(113,000)
Other accrued liabilities	51,000	(4,000)
Net cash provided by (used in) operating activities	(225,000)	7,000
Investing activities:		
Acquisition of furniture and equipment	(111,000)	(107,000)
Proceeds from sale of equipment		5,000
Net cash used in investing activities	(111,000)	(102,000)
Financing activities:		
Net line of credit borrowings	289,000	83,000
Payments on related party note payable	(19,000)	(10,000)
Proceeds from (payments on) notes payable	(28,000)	47,000
Payments on capital lease obligations	(10,000)	(2,000)
Payments of dividends	(3,000)	(3,000)
Net cash provided by financing activities	229,000	115,000
Net increase (decrease) in cash	(107,000)	20,000
Cash at beginning of period	260,000	25,000
Cash at end of period	\$ 153,000	\$ 45,000
Supplemental disclosure of cash flow data:		
Interest paid	\$ 37,000	\$ 20,000
Income taxes paid	\$ 73,000	\$ 234,000

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) In the opinion of the Registrant, the unaudited financial information in this report reflects all adjustments, consisting only of normal recurring accruals, which are considered necessary for a fair presentation of its financial position as of September 28, 2002 and its results of operations and cash flows for the periods shown. Certain information and footnote disclosures normally included in financial statements prepared in conformity with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to SEC regulations. It is suggested that these financial statements be read in conjunction with the audited financial statements included in the Registrant's Report on Form 10-KSB for the fiscal year ended June 30, 2002.

(2) Basic net income per common share is calculated by dividing net income applicable to common stock by the weighted average number of common shares outstanding during the period. The calculation of diluted income per common share is similar to that of basic income per common share, except that the denominator is increased to include the number of additional common shares that would have been outstanding if all potentially dilutive common shares, principally those issuable upon the conversion of preferred stock and the exercise of stock options, were issued during the period.

The following table summarizes the calculation of basic and diluted earnings per common share for each period:

	Three months ended	
	September 28, 2002	September 29, 2001
Numerators:		
Net income (A)	\$ 62,000	\$ 100,000
Deduct preferred dividend requirements	3,000	3,000
Net income applicable to common stock (B)	<u>\$ 59,000</u>	<u>\$ 97,000</u>
Denominators:		
Weighted average shares for basic net income per common share (C)	4,925,444	3,379,635
Add effects of dilutive securities from assumed exercise of stock options and warrants and conversion of notes payable	<u>427,463</u>	<u>341,760</u>
Weighted average shares for diluted net income per common share (D)	<u>5,352,907</u>	<u>3,721,395</u>
Basic net income per common share (B/C)	<u>\$ 0.01</u>	<u>\$ 0.03</u>
Diluted net income per common share (B/D)	<u>\$ 0.01</u>	<u>\$ 0.03</u>

(3) The results of operations for the three months ended September 28, 2002 are not necessarily indicative of the results to be expected for the full year.

(4) The Company's fiscal year is from July 1 through June 30. The Company uses the 5-4-4 weeks per period method for each quarter; periods one (July) and twelve (June) may vary slightly in the actual number of days due to the beginning and end of each fiscal year.

(5) The Company's primary source of liquidity is its \$1,500,000 revolving line of credit facility under a loan agreement with Comerica Bank-California that expires on December 28, 2003. The loan is collateralized by all of the Company's assets including contract receivables. Comerica Bank-California advances funds to the Company of up to 80% of the Company's billed contract receivables which are less than 90 days old. Comerica Bank-California charges an interest rate of 0.750% over prime.

(6) The Company reports segment sales in the same format reviewed by the Company's Chief Operating Decision Maker ("CODM"). The CODM identifies the Company's segments based on the customer base. These segments offer services to different markets in accordance with their customer base. Accordingly, the Company's two business segments are centered on the operations associated with the SYS Government Services Division ("SYS") and the Testmasters Division ("Testmasters"). All of the Company's operations are conducted in the United States. The Company evaluates the performance of each segment based on income or loss before income taxes. The Company has no significant intersegment sales or transfers.

Net revenues, income (loss) before income taxes and other related segment information for the first three months of fiscal years 2003 and 2002 follows:

	<u>SYS</u>	<u>Testmasters</u>	<u>Total</u>
<u>2003</u>			
Net revenues	\$5,093,000	\$155,000	\$5,248,000
Income before income taxes	88,000	16,000	104,000
Total assets	6,998,000	119,000	7,117,000
	<u>SYS</u>	<u>Testmasters</u>	<u>Total</u>
<u>2002</u>			
Net revenues	\$3,422,000	\$112,000	\$3,534,000
Income (loss) before income taxes	225,000	(62,000)	163,000
Total assets	3,957,000	361,000	4,318,000

(7) Changes in Securities

On August 28, 2002, the Board of Directors granted options to purchase 281,500 shares of common stock. All of these stock options were granted to employees of the Company at fair market value.

On September 13, 2002, the Company issued 54,443 shares of common stock to the Company's 401(k)/Employee Stock Ownership Plan. These shares, which had a fair value of \$73,000, were part of the Company's contribution to the employees for 2002.

(8) Legal

The Company and four employees were sued by Systems Integration & Research, Inc. ("SIR"), in the Circuit Court for Fairfax County, Virginia, on February 14, 2002. The crux of the complaint is that the Company and the named defendants conspired to divert a financial management and technical assistance contract that SIR was performing for the U.S. Navy, Naval Sea Systems Command. According to the complaint, the Company and the named defendants violated Virginia business conspiracy statutes, tortiously interfered with SIR's contract with the Navy, interfered with SIR's business expectancy for the successor contract, and stole and converted a database and computer program that SIR had compiled for the Navy. In addition, the complaint alleges that one of the Company's employee-defendants breached her fiduciary duty to SIR. The relief SIR is seeking is \$15,000,000 in damages, plus \$350,000 in punitive damages. Defendants filed a demurrer, arguing that this was really a complaint against the Navy's award of the successor contract to the Company, and that only a federal court had jurisdiction over a claim concerning the award of a U.S. Government contract. The defendants also have substantial defenses on the merits. Although the demurrer was denied, the issue has been preserved for appeal. The Company has hired counsel and will vigorously defend the lawsuit. While the Company believes it has no liability in this matter, there can be no assurance that SIR will not be successful in asserting that the Company is liable to them. At this time, the Company is not able to predict the outcome of this litigation and there can be no assurance that the Company will not incur substantial and protracted litigation costs.

Item 2. Management's Discussion and Analysis or Plan of Operations

To the extent that the information presented in this quarterly report discusses financial projections, information or expectations about our business plans, results of operations, products or markets, or otherwise makes statements about future events, such statements are forward-looking. Such forward-looking statements can be identified by the use of words such as “intends,” “anticipates,” “believes,” “estimates,” “projects,” “forecasts,” “expects,” “plans” and “proposes.” Although we believe that the expectations reflected in these forward-looking statements are based on reasonable assumptions, there are a number of risks and uncertainties that could cause actual results to differ materially from such forward-looking statements. These include, among others, the cautionary statements in the “Factors Which May Affect Future Results” and “Management’s Discussion and Analysis or Plan of Operations” sections of this report. These cautionary statements identify important factors that could cause actual results to differ materially from those described in the forward-looking statements. When considering forward-looking statements in this report, you should keep in mind the cautionary statements in the “Factors Which May Affect Future Results” and “Management’s Discussion and Analysis or Plan of Operations” sections, and other sections of this report.

New Accounting Pronouncements

During 2002, the Company elected early adoption of the provisions of Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. The adoption of the new standard did not have any effect on the accompanying condensed consolidated financial statements.

In June 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 146, Accounting for Costs Associated with Exit or Disposal Activities (“Statement 146”). Management does not believe that the adoption of Statement 146 will have a material impact on the Company’s financial position or results of operations.

Description of Business

The Company provides engineering, management and technical services to public and private sector customers. The Company was formed and incorporated in the State of California in 1966 as Systems Associates, Inc. It became a public corporation in 1968 and engaged in systems analysis, systems engineering, computer services and software for government and industry. The Company changed its name to Systems Associates, Inc. of California on December 4, 1979, and, as of March 18, 1985, it was changed to SYS. On June 19, 2002, the Board of Directors adopted a resolution to use the DBA of SYS Technologies, Inc. The Company corporate offices were moved to San Diego, California on February 19, 1984, from Long Beach, California. On May 4, 2001, the Company purchased all of the stock of Testmasters, Inc. (Testmasters), which is now our wholly owned subsidiary. On March 27, 2002, the Company purchased all of the stock of Shadow Research International, Inc. (Shadow Research), which is now our wholly owned subsidiary.

The Company currently provides engineering, management and technical consulting services to various agencies of the U.S. government and private industry, as a prime contractor and subcontractor. The specific services provided are primarily in the fields of:

Systems Engineering
Naval Architecture and Marine Engineering
Program Management
Environmental Engineering
Electronic Record Management
Information Operations
Effects Based Planning
Software Training
Joint C4I Architecture

Management and Analysis Consulting
Software Development & Testing
Information Management Systems
Logistics Analysis and Engineering
Cost Analysis and Forecasting
Theater Assessment Profiling
Total Ownership Cost
Data Fusion and Knowledge Management
Information Assurance

The Underway Replenishment (UNREP) Program had its third of three option years exercised on December 1, 2000, which expired on November 30, 2001. This cost plus fixed fee contract was extended through September 30, 2002. The Company was notified on September 4, 2002 that it had won the UNREP recompete contract and the new contract became effective on September 16, 2002. The new contract, which is also cost plus fixed fee, is valued at \$39.5 million over its ten year life, assuming that all options are exercised. The base year of this new contract is valued at \$3.3 million. This program accounted for about 10% of the Company's revenue in the first quarter of fiscal year 2003. The program provides in-service engineering to the U.S. Navy Fleet. The Company has supported this Navy program in various roles since 1982. This work is performed by the Company's Oxnard office.

The Management, Planning, Analytical and Administrative (MPAA) Program had its second of four option years exercised on February 1, 2002. This second option year is valued at \$4.3 million. This program accounted for about 29% of the Company's revenue in the first quarter of fiscal year 2003. This contract, which is cost plus fixed fee, supports the U.S. Navy's Port Hueneme Division, Naval Surface Warfare Center. The MPAA program has received customer recognition for its high standards of excellence and professionalism. This fiscal year, the government rated the Company's performance as outstanding for both the base and option years of the contract. This work is performed by the Company's Oxnard office.

The Company is continuing to provide hazardous materials assessment support to the Naval Air Systems Command through a subcontract. This support provides environmental engineering and technical services focusing on the identification and reduction of hazardous material when providing maintenance to weapons and associated handling and shipping equipment. Hazardous material reduction support is being expanded to include support for Foreign Military Sales. This work is performed by the Company's Oxnard office.

The Company has three contracts from the General Services Administration (GSA). These three contracts are for Information Technology, Financial Management Services and Professional Engineering Services. These contracts, which are time and material, have proven to be successful as a means to develop new customers and they are registered in the GSA Advantage System. The GSA Advantage System is an on-line service provided by GSA that lists the price schedules for all registered companies. The GSA contracts accounted for about 29% of the Company's revenue in fiscal year 2002. All of the Company's offices utilize these GSA contracts.

The Company continues to provide Electronic Records Management (ERM) services. The Company's Information Technology (IT) GSA contract was amended to include ERM services. This work is performed by the Company's Oxnard office.

The Company is continuing to provide support services for information technology services through a subcontract in support of the Navy Marine Corps Intranet (NMCI). This program

accounted for about 4% of the Company's revenue in the first quarter of fiscal year 2003. This work is performed by the Company's Oxnard office.

The Company's Command, Control, Communication, Computer and Intelligence (C4I) group is primarily based in San Diego. This group is providing top-level C4I system engineering services; system architecture design; advanced concept development; test and evaluation; effects-based operation planning, execution and assessment; program management and business development support; organizational management analysis; and information technology and information operations (IO) support. The customer base includes SPAWAR Systems Center San Diego and U.S. Navy Commander in Chief, Pacific. The C4I personnel work closely with Office of Naval Research, Defense Advanced Research Programs Agency, Assistant Secretary of the Navy for Research, Development and Acquisition, Chief of Naval Operations, Naval Warfare Development Command, Joint Forces Command, and other services and Joint Agencies.

The Company is a subcontractor to Science Applications International Corporation (SAIC) on its SPAWAR Systems Engineering & Integration contract. This program accounted for about 13% of the Company's revenue in the first quarter of fiscal year 2003. This work is performed by the Company's San Diego office.

On September 28, 2001, the Company signed its Prime contract that was awarded as the result of full and open competition for technical support to SPAWAR Systems Center's Joint and National Systems Division. The subcontractors on the Company's winning team were BAE and TRW. Significant efforts include providing system engineering and architecture development for the Joint Strike Fighter, Unmanned Aerial Vehicle, Surveillance and Precision Engagement Programs. This program accounted for about 4% of the Company's revenue in the first quarter of fiscal year 2003. This work is performed by the Company's San Diego office.

The Company is a subcontractor on the Naval Sea Systems Command's Professional Support Services contract. The Company received a subcontract effective January 1, 2002. This contract has a base year and four option years. This program accounted for about 4% of the Company's revenue in the first quarter of fiscal year 2003. Most of the work for this contract is being performed out of the Company's Chesapeake office.

The Company's subsidiary, Shadow Research, is a technology-based consulting services organization providing support for the Navy Logistics Productivity's (NLP) Research and Development program. Shadow has a subcontract to execute the NLP Bounty Hunter Program that focuses on expansion of the technology emphasis to all aspects of system obsolescence whether it is electronic, mechanical, or hydraulic and targets both functional and economic cases. Shadow is also a Technology Trends Data Base subcontractor. This project establishes and maintains a current, accurate and accessible repository of component-level trend information for weapon and weapon support systems obsolescence management using the Navy's Logistics Productivity Obsolescence Prediction Tool (OPT). The OPT will be the principal tool employed in the proactive prediction of obsolescence, and in providing a methodology for evaluating the best corrective action.

The Company's subsidiary, Testmasters, Inc., specializes in establishing and deploying effective software testing methodologies and disciplines. Testmasters' Testing and Quality Assurance focus is to provide its clients early warnings of issues or processes that will inhibit the success of the project. Testmasters' consultants rely on proven disciplines and practices that stem from a long history of successful engagements wherein Testmasters provided the primary test support and Quality Assurance services to their clients. These services have included: Independent Verification and Validation (IV&V); test planning; test procedures development; test life cycle development and practices assessment (policies and procedures); creation of test permutation definitions and scripts; test execution and test management; test tool selection and integration; and testing and quality

assurance training. Since Testmasters' primary business focus is quality assurance and testing, the completion of each assignment adds to its wealth of expertise, experience and understanding of real world project dynamics and potential impediments to their success. Testmasters' IV&V services reflect a combination of pragmatic processes and personnel experienced in their application and review. Testmasters has developed a suite of software tools to be used in its information securities business.

In the first quarter of FY 2003, the Company consolidated its training capabilities and established the SYS Training Division and opened a new office in Carlsbad, California. The Training Division brings together some of the Company's existing training capabilities with a new group that will be offering a wide range of instructor led training courses for Sun UNIX, Java Programming, Microsoft Windows and Desktop Publishing Applications. As a Microsoft Certified Partner, the Company now offers a full line of Microsoft classes, including Microsoft Applications, NT and Windows 2000.

Results of Operations

The Company's revenue for this quarter is about 49% more revenue than in the same quarter in FY 2002. The primary reasons for the increase in revenue are new work through our East Coast office and additional tasking on the Company's GSA, UNREP and MPAA contracts.

Total contract and general and administrative expenses were 97% as a percentage of contract revenue for the first three months of FY 2003 and 95% for FY 2002. The Company's Training group has incurred start up costs of about \$81,000 in this quarter. Additional start up costs are anticipated for the second quarter of 2003. Interest expense is higher due to the debt associated with the private placement.

Income from operations, as a percentage of revenue, is 3% and 5% in FY 2003 and 2002, respectively. Net income is \$62,000 as compared to \$100,000 for the prior year. The negotiated contract backlog was approximately \$15,820,000 at the end of the first quarter of FY 2003 compared to \$10,884,000 for the same quarter in FY 2002, an increase of 45%.

Liquidity and Capital Resources

The Company had contract receivables (net) of \$5,173,000 at the end of the first quarter of FY 2003. For the same quarter in FY 2002, the contract receivables (net) were \$3,310,000. The reason for the increase in contract receivables is due to the Company's increased revenue.

The Company had accounts payable of \$611,000 at the end of the first quarter of FY 2003. For the same quarter in FY 2002 the accounts payable were \$360,000. The increased revenue has been generated through additional hires; these additional hires generally require new office and computer equipment which increases accounts payable. The Company had several subcontractors awaiting payment at period end.

The outstanding balance on the Company's revolving line of credit with Comerica Bank-California was \$289,000 at the end of the first quarter of FY 2003. At the end of the same period in FY 2002, the line of credit balance was \$803,000.

The Company's primary source of liquidity is its \$1,500,000 revolving line of credit facility

under a loan agreement with Comerica Bank-California that expires on December 28, 2003. The loan is collateralized by all of the Company's assets including contract receivables. Comerica Bank-California advances funds to the Company of up to 80% of the Company's billed contract receivables which are less than 90 days old. Comerica Bank-California charges an interest rate of 0.750% over prime.

Management believes that the Company will have sufficient cash flow from operations and funds available under the revolving credit agreement with Comerica Bank-California to finance its current operating and capital requirements through at least the current fiscal year. Long-term liquidity depends on the Company's ability to manage cash, raise cash and maintain profitability.

Several key factors indicating the Company's financial condition include:

	<u>September 28, 2002</u>	<u>June 30, 2002</u>
Current ratio	2.48	3.17
Debt to net worth	1.20	1.02
Net worth	\$3,232,000	\$3,100,000
Net working capital	\$3,564,000	\$3,599,000
Debt to total assets	55%	51%
Book value per common share	\$0.65	\$0.63

Certain factors that may effect the Company's financial performance are beyond the Company's control. The current ratio is derived by dividing total current assets by total current liabilities. Debt to net worth is calculated by dividing total liabilities (total current liabilities plus other liabilities) by net worth. Net worth is total stockholders' equity. Net working capital is total current assets less total current liabilities. Debt to total assets is total liabilities divided by total assets. Book value per common share is stockholders' equity related to common shares divided by the number of common shares outstanding at the end of the period.

Item 2a. Factors Which May Affect Future Results

Information contained in this Form 10-QSB should be studied carefully by any potential investor while considering the following risk factors to the Company.

1. Lack of Business Diversification The majority of the Company's business at the present time is with the U.S. Navy. The Company has successfully grown and diversified its U.S. Navy business to several contracts and subcontracts. Even with this growth and diversification, budget changes in Congress or the Defense Department could seriously affect the Company.

2. Dependence on Key Personnel The Company has a few key management, project and technical personnel that are intimately involved in their functions and have day to day relationships with critical customers. The Company is not able to afford extra standby staff. As a result, at its current size, the loss of any of these key personnel could have a material and adverse affect on the Company.

3. Competition The Company has many competitors who vie for the same customers as the Company. They are competent, experienced and continuously working to take work projects

away from the Company. Many of the competitors have substantially greater resources than the Company.

4. Limited Assets of the Company The Company has very limited assets upon which to rely for adjusting to business variations and for growing new businesses. While the Company is likely to look for new funding to assist in the acquisition of other profitable businesses, it is uncertain whether such funds will be available. While the Company's management believes that its financial policies have been prudent, the Company's substantial reliance on a bank loan with Comerica Bank and other short-term accruals impose certain limitations on the Company. If the Company is to grow and expand its operations, the Company will need to raise significant amounts of additional capital. There can be no assurance that the Company will be successful in raising a sufficient amount of additional capital, or if it is successful, that the Company will be able to raise capital on reasonable terms in light of the Company's current circumstances. In the event that the Company raises additional capital, the Company's existing stockholders may incur substantial and immediate dilution.

5. Limited Market for Common Stock. The Company's stock is traded (OTC) on the Electronic Bulletin Board. Trading for the stock is sporadic and at present there is a limited market for the Company's Common Stock. There can be no assurance that a more liquid market will in fact develop. Even if such market does develop, it may not be sustained.

6. Possible Rule 144 Stock Sales. As of September 28, 2002, a total of 2,012,919 shares of the Company's outstanding Common Stock are "restricted securities" and may be sold only pursuant to a registration statement or in compliance with Rule 144 adopted under the Securities Act of 1933 or other applicable exemptions from registration. Rule 144 provides that a person holding restricted securities for a period of one year may thereafter sell, in brokerage transactions, an amount not exceeding in any three-month period the greater of either (i) 1% of the Company's outstanding Common Stock, or (ii) the average weekly trading volume during a period of four calendar weeks immediately preceding any sale. Persons who are not affiliated with the Company and who have held their restricted securities for at least two years are not subject to the volume limitation. Possible or actual sales of the Company's Common Stock by present shareholders under Rule 144 may have a depressive effect on the price of the Company's Common Stock in any market which may develop.

7. Risks of Low Priced Stocks. Trading in the Company's stock is limited. Consequently, a shareholder may find it more difficult to dispose of, or to obtain, accurate quotations as to the price of, the Company's securities. In the absence of a security being quoted on NASDAQ, AMEX or the NYSE, trading in the Common Stock is covered by Rule 3a51-1 promulgated under the Securities Exchange Act of 1934 for non-NASDAQ and non-exchange listed securities.

Under such rules, broker/dealers who recommend such securities to persons other than established customers and accredited investors (generally institutions with assets in excess of \$5,000,000 or individuals with net worth in excess of \$1,000,000 or an annual income exceeding \$200,000 or \$300,000 jointly with their spouse) must make a special written suitability determination for the purchaser and receive the purchaser's written agreement to a transaction prior to sale. Securities are also exempt from this rule if the market price is at least \$5.00 per share, or, for warrants, if the warrants have an exercise price of at least \$5.00 per share. The Securities Enforcement and Penny Stock Reform Act of 1990 requires additional disclosure to the market for penny stocks and for trades in any penny stock defined as a penny stock.

The Commission has recently adopted regulations under such Act which define a penny stock to be any NASDAQ or non-NASDAQ equity security that has a market price or exercise price of less than \$5.00 per share.

In addition, unless exempt, the rules require the delivery, prior to any transaction involving a penny stock, of a disclosure schedule prepared by the Commission explaining important concepts involving a penny stock market, the nature of such market, terms used in such market, the broker/dealer's duties to the customer, a toll-free telephone number for inquiries about the broker/dealer's disciplinary history, and the customer's rights and remedies in case of fraud or abuse in the sale.

Disclosure also must be made about commissions payable to both the broker/dealer and the registered representative, current quotations for the securities and, if the broker/dealer is the sole market maker, the broker/dealer must disclose this fact and its control over the market.

Monthly statements must be sent disclosing recent price information for the penny stock held in the account and information on the limited market in penny stocks. While many NASDAQ stocks are covered by the proposed definition of a penny stock, transactions in NASDAQ stocks are exempt from all but the sole market-maker provision for (i) issuers with \$2,000,000 in tangible assets (\$5,000,000 if the issuer has not been in continuous operation for three years), (ii) transactions in which the customer is an institutional accredited investor and (iii) transactions that are not recommended by the broker/dealer. In addition, transactions in a NASDAQ security directly with the NASDAQ market maker for such securities, are subject only to the sole market-maker disclosure, and the disclosure with regard to commissions to be paid to the broker/dealer and the registered representatives.

8. Control by Officers and Directors. As of September 28, 2002, officers and Directors of the Company own 47.9% or 2,749,355 shares of the Company's common stock including any stock options exercisable within 60 days of September 28, 2002 and thereby control the Company's affairs.

9. Acquisitions. The Company has announced an aggressive growth strategy, which includes growth from within and through acquisitions.

Item 3. Controls and Procedures

Within 90 days prior to the date of this quarterly report on Form 10-QSB for the first quarter ended September 28, 2002, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and President, the principal executive officers and the Company's Chief Financial Officer, our principal financial officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Rule 13a-14 of the Securities Exchange Act of 1934. Based upon that evaluation, these principal executive officers and principal financial officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company, including its consolidated subsidiaries, required to be included in the Company's periodic SEC filings. There were no significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The Company and four employees were sued by Systems Integration & Research, Inc. ("SIR"), in the Circuit Court for Fairfax County, Virginia, on February 14, 2002. The crux of the complaint is that the Company and the named defendants conspired to divert a financial management and technical assistance contract that SIR was performing for the U.S. Navy, Naval Sea Systems Command. According to the complaint, the Company and the named defendants violated Virginia business conspiracy statutes, tortiously interfered with SIR's contract with the Navy, interfered with SIR's business expectancy for the successor contract, and stole and converted a database and computer program that SIR had compiled for the Navy. In addition, the complaint alleges that one of the Company's employee Defendants breached her fiduciary duty to SIR. The relief SIR is seeking is \$15,000,000 in damages, plus \$350,000 in punitive damages. Defendants filed a demurrer, arguing that this was really a complaint against the Navy's award of the successor contract to the Company, and that only a federal court had jurisdiction over a claim concerning the award of a U.S. Government contract. The defendants also have substantial defenses on the merits. Although the demurrer was denied, the issue has been preserved for appeal. The Company has hired counsel and will vigorously defend the lawsuit. While the Company believes it has no liability in this matter, there can be no assurance that the Plaintiff will not be successful in asserting that the Company is liable to them. The Company is not able to predict the outcome of this litigation and there can be no assurance that the Company will not incur substantial and protracted litigation costs.

The Company has filed a lawsuit in California Superior Court against Systems Integration and Research, Inc. ("SIR") and C Cubed, Corp., its parent. The case alleges damages suffered by the Company as a result of a failed acquisition attempt by the Company of SIR. The Company entered into an exclusive negotiating agreement to purchase SIR Corp. During the exclusivity period, SIR "shopped" the Company's bid, negotiated with other entities (including the one that finally purchased SIR) and shared with those entities due diligence materials that belonged exclusively to the Company. A complaint has been filed and an answer and cross complaint has been filed by the defendants, in response. We expect a vigorous defense, but the documents and testimony seem to indicate that what we have alleged did in fact occur, injuring the company. Therefore, we expect a positive outcome should the matter be tried. However, we have no guarantee that we will not be unsuccessful in pursuit of this matter or that SIR will not be successful in its cross complaint. However, the cross complaint simply mirrors the complaint and will be extremely hard to sustain.

Item 2. Changes in Securities

On August 28, 2002, the Board of Directors granted options to purchase 281,500 shares of common stock. All of these stock options were granted to employees of the Company.

On September 13, 2002, the Company issued 54,443 shares of common stock to the Company's 401(k)/Employee Stock Ownership Plan. These shares were part of the Company's contribution to the employees for 2002.

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Securities Holders

None

Item 5. Other Information

Effective July 1, 2000, the Board of Directors approved its current compensation plan for the outside directors of the Company. Under the compensation plan, each outside director will receive \$1,000 per Board of Director meeting. In addition, each outside director will receive stock options for 1,000 shares of common stock for each Board of Directors meeting attended by the director. Directors receive additional compensation for work performed on the Board's committees. For the Company's first quarter (July through September) the stock option price is \$1.18 per share. The stock option price is updated quarterly.

Item 6. Exhibits and Reports on Form 8-K

On September 30, 2002, the Company filed an 8-K announcing its Quarterly Reports on Form 10-QSB that it had filed for the periods ended December 29, 2001 and March 30, 2002 included errors.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SYS
(Registrant)

Date: November 8, 2002

/s/ W. Gerald Newmin
W. Gerald Newmin
Chief Executive Officer