ENGINEERED SUPPORT SYSTEMS INC
Form 10-Q
June 16, 2003

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

Quarterly Report under Section 13 or 15 (d)

of the Securities Exchange Act of 1934

For the six months ended April 30, 2003   Commission file number 0-13880

ENGINEERED SUPPORT SYSTEMS, INC.
(Exact name of Registrant as specified in its charter)

Missouri	43-1313242
(State of Incorporation)	(IRS Employer Identification Number)

201 Evans Lane, St. Louis, Missouri	63121
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number including area code: (314) 553-4000

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

Indicate by check mark whether the Registrant is an accelerated filer (as defined by Rule 12b-2 of the Exchange Act). Yes X No

The number of shares of the Registrant's common stock, $.01 par value, outstanding at May 30, 2003 was 16,123,957.

ENGINEERED SUPPORT SYSTEMS, INC.

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ENGINEERED SUPPORT SYSTEMS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except per share amounts)

	April 30 2003 (Unaudited)
ASSETS	
Current Assets	
Cash and cash equivalents	$ 14,943
Accounts receivable	46,357
Contracts in process and inventories	23,290
Deferred income taxes	6,660
Other current assets	6,798
Current assets of discontinued operations	
Total Current Assets	98,048
Property, plant and equipment, less accumulated depreciation of $28,000 and $25,464	44,963
Goodwill	108,452
Deferred income taxes	6,885
Other assets	21,481
Long-term assets of discontinued operations	

Total Assets	$ 279,829
LIABILITIES AND SHAREHOLDERS' EQUITY	
Current Liabilities	
Notes payable	$ 15,000
Current maturities of long-term debt	
Accounts payable	29,548
Other current liabilities	40,001
Current liabilities of discontinued operations	
Total Current Liabilities	84,549
Long-term debt	
Additional minimum pension liability	20,334
Other liabilities	14,723
Shareholders' Equity	
Common stock, par value $.01 per share; 30,000 shares authorized; 17,021 and 16,991 shares issued	170
Additional paid-in capital	100,330
Retained earnings	101,887
Accumulated other comprehensive loss	(14,098)
	188,289
Less treasury stock at cost, 903 and 1,171 shares	28,066
	160,223
Total Liabilities and Shareholders' Equity	$ 279,829

See notes to condensed consolidated financial statements.

ENGINEERED SUPPORT SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share amounts)

	Three Months Ended April 30	
	2003	2002
Net revenues	$ 125,057	$ 91,780
Cost of revenues	95,274	70,018
Gross profit	29,783	21,762
Selling, general and administrative expense	14,467	10,305
Restructuring expense	1,193	

Operating income from continuing operations	14,123	11,457	
Interest expense	(271)	(756)	
Interest income	48	60	
Gain on sale of assets			
Income from continuing operations	13,900	10,761	
Income tax provision	5,421	4,197	
Net income from continuing operations	8,479	6,564	
Discontinued operations:			
Income (loss) from discontinued operations, net of income tax	157	(143)	
Estimated loss on disposal, net of income tax		(3,145)	
Net income	$ 8,636	$ 3,276	
Basic earnings per share:			
Continuing operations	$ 0.53	$ 0.42	
Discontinued operations:			
Income (loss) from discontinued operations, net of income tax	0.01	(0.01)	
Estimated loss on disposal, net of income tax		(0.20)	
Total	$ 0.54	$ 0.21	
Diluted earnings per share:			
Continuing operations	$ 0.50	$ 0.41	
Discontinued operations:			
Income (loss) from discontinued operations, net of income tax	0.01	(0.01)	
Estimated loss on disposal, net of income tax		(0.20)	
Total	$ 0.51	$ 0.20	

See notes to condensed consolidated financial statements.

ENGINEERED SUPPORT SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

(UNAUDITED)

	Six Months April 3
	2003
From operating activities:	
Net income from continuing operations	$ 16,920
Depreciation and amortization	4,371
Gain on sale of assets	(6)
Cash provided before changes in operating assets and liabilities	21,285
Net decrease in non-cash current assets	17,571
Net increase (decrease) in non-cash current liabilities	8,253
Decrease in other assets	2,097
Net cash provided by continuing operations	49,206
Net cash provided by discontinued operations	1,885
Net cash provided by operating activities	51,091
From investing activities:	
Contingent consideration paid for purchase of UPSI	(5,008)
Additions to property, plant and equipment	(5,314)
Proceeds from sale of property, plant and equipment	22
Net cash used in continuing operations	(10,300)
Net cash provided by discontinued operations	3,696
Net cash used in investing activities	(6,604)
From financing activities:	
Net payments under line-of-credit agreement	2,000
Payments of long-term debt	(42,000)
Purchase of treasury stock	(557)
Exercise of stock options	6,508
Cash dividends	(288)
Net cash used in continuing operations	(34,337)
Net cash used in discontinued operations	
Net cash used in financing activities	(34,337)
Net increase in cash and cash equivalents	10,150

Cash and cash equivalents at beginning of period	4,793
Cash and cash equivalents at end of period	$ 14,943

See notes to condensed consolidated financial statements.

ENGINEERED SUPPORT SYSTEMS, INC.
NOTES TO CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS (UNAUDITED)
(in thousands, except per share amounts)
APRIL 30, 2003

NOTE A - BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements have been prepared by the Company without audit. In the opinion of management, all adjustments (including normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six month periods ended April 30, 2003 are not necessarily indicative of the results to be expected for the entire fiscal year.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial statements and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report to shareholders for the year ended October 31, 2002.

NOTE B - EARNINGS PER SHARE

Average diluted common shares outstanding include common stock equivalents, which represent common stock options as computed based on the treasury stock method. Average basic and diluted common shares outstanding have been restated to reflect a three-for-two stock split effected by the Company on October 31, 2002 in the form of a stock dividend.

Basic earnings per share for the three months ended April 30, 2003 and 2002 is based on average basic common shares outstanding of 16,078 and 15,476, respectively. Diluted earnings per share for the three months ended April 30, 2003 and 2002 is based on average diluted common shares outstanding of 17,010 and 16,055, respectively.

Basic earnings per share for the six months ended April 30, 2003 and 2002 is based on average basic common shares outstanding of 15,995 and 15,408, respectively. Diluted earnings per share for the six months ended April 30, 2003 and 2002 is based on average diluted common shares outstanding of 16,926 and 15,989, respectively.

NOTE C - STOCK-BASED COMPENSATION

The Company applies Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for all stock option plans. Accordingly, no compensation expense has been recognized for stock option awards. The following table illustrates the effect on net income from continuing operations and earnings per share had the Company applied the fair value recognition provisions of Statement of

Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation," to stock option awards.

	Three Months Ended April 30		S
	2003	2002	2
Reported net income from continuing operations	$8,479	$6,564	$16
Total stock-based employee compensation expense determined under the fair value method for all stock option awards, net of income tax	648	184	
Pro forma net income from continuing operations	$7,831	$6,380	$16
Earnings per share from continuing operations:			
Basic - as reported	$ 0.53	$ 0.42	$
Basic - pro forma	$ 0.49	$ 0.41	$
Diluted - as reported	$ 0.50	$ 0.41	$
Diluted - pro forma	$ 0.46	$ 0.40	$

The fair value of options at the grant date was estimated using the Black-Scholes model with the following weighted average assumptions for the three and six months ended April 30, 2003 and 2002: an expected life of 1.5 years, volatility of 51%, a dividend yield of 0.16% and a risk-free interest rate of 3.74%. The weighted average fair value of options granted in the three and six months ended April 30, 2003 and 2002 was $7.66.

NOTE D - ACQUISITIONS

On May 10, 2002, the Company acquired all of the outstanding common stock of Radian, Inc., a supplier of engineering, logistics support and systems integration services to the U.S. Department of Defense. The purchase price was approximately $42.0 million, which included consideration of $2.0 million in the common stock of the Company. The purchase price is net of $0.4 million of cash acquired. The fair value of the assets acquired, including goodwill of $26.6 million and customer-related intangibles of $15.3 million, was $58.3 million and liabilities assumed totaled $16.3 million. (Acquired customer-related intangibles, less $2.8 million of amortization to date, are included on the April 30, 2003 Condensed

Consolidated Balance Sheet in Other Assets.) The cash portion of the purchase price was financed with available cash resources and short-term borrowings under the Company's revolving credit facility.

On June 27, 2002, the Company acquired all of the outstanding common stock of Universal Power Systems, Inc. (UPSI), a provider of uninterruptible power supply systems for the U.S. Department of Defense, intelligence agencies and commercial customers. The purchase price was approximately $5.5 million plus certain contingent cash consideration based upon UPSI's net revenue levels through two measurement dates, December 31, 2002 and October 31, 2003. Based upon UPSI's net revenue through the December 31, 2002 measurement date, $5.0 million of cash consideration was added to the purchase price and paid during the quarter ended April 30, 2003. (The Company estimates the maximum amount of contingent cash consideration related to the October 31, 2003 measurement date to be $0.6

million). The fair value of the assets acquired, including goodwill of $10.4 million, was $11.6 million and liabilities assumed totaled $1.2 million. The purchase price was financed with short-term borrowings under the Company's revolving credit facility.

Both companies are included in the Light Military Support Equipment segment.

NOTE E - OTHER COMPREHENSIVE INCOME (LOSS)

The Company's other comprehensive income (loss) for the three months ended April 30, 2003 and 2002 was $0 and $188, respectively. The Company's other comprehensive income (loss) for the six months ended April 30, 2003 and 2002 was $177 and $338, respectively. The components of other comprehensive income (loss) include a minimum pension liability adjustment and an adjustment to the fair value of derivatives.

NOTE F - GOODWILL AND INTANGIBLE ASSETS

The following disclosure presents certain information on the Company's acquired intangible assets as of April 30, 2003 and October 31, 2002. All acquired intangible assets are being amortized over their estimated useful lives with no estimated residual values. These amounts are included in Other Assets in the Condensed Consolidated Balance Sheets.

	Weighted Average Amortization Period	Gross Amount	Accumulated Amortization
Customer-related intangibles:			
April 30, 2003	5.4 years	$ 15,309	$ 2,840
October 31, 2002	5.4 years	15,309	1,420

The amortization expense related to acquired intangible assets was $710 for the three months ended April 30, 2003 and $1,420 for the six months ended April 30, 2003. Related estimated amortization expense is $2,840

annually through the year ended October 31, 2006, and $2,529 for the year ended October 31, 2007. There was no amortization expense related to acquired intangible assets for the three and six months ended April 30, 2002.

NOTE G - OPERATIONAL RESTRUCTURING

During the quarter ended July 31, 2002, the Company announced a restructuring plan to improve both plant utilization and long-term profitability. Under the plan, the Company's Blue Ash, Ohio and Olivette, Missouri manufacturing locations will be closed during the year ending October 31, 2003 with related production efforts being relocated to other existing Company facilities. Emerging Issues Task Force No. 94-3 (ETIF 94-3), which was effective through December 31, 2002, provided specific requirements as to the appropriate recognition of restructuring costs associated with employee termination benefits and other exit costs. Employee termination costs are recognized when benefit arrangements are communicated to affected employees in sufficient detail to enable the employees to determine the amount of benefits to be received upon termination. Other costs resulting from the restructuring plan that

are not associated with or that do not benefit activities that will be continued are recognized at the date of commitment to the plan subject to certain conditions. For the cost to be accrued, it must not be associated with or incurred to generate revenues after the commitment date, and must be either incremental to other costs incurred prior to the commitment date or represent amounts under a contractual obligation that existed prior to the commitment date that will either continue after the plan is completed with no economic benefit or which will result in a penalty to cancel the obligation. Other costs directly related to the restructuring plan which are not eligible for recognition at the commitment date, such as relocation and other integration costs, are expensed as incurred. The plan will involve terminating 113 employees, 60 of which had been terminated as of April 30, 2003.

During the six months ended April 30, 2003, the Company recorded the following costs in connection with this restructuring plan.

	Accrued at October 31, 2002	Expensed	Utilized
Severance and related benefits	$ 789	$	$ 384
Other cash restructuring costs	153		
Restructuring costs, excluding non-cash items	$ 942	$	$ 384

During the quarter ended April 30, 2003, the Company announced an additional restructuring plan under which the electronics assembly work currently performed at the Company's Sanford, Florida facility of its Systems & Electronics Inc. (SEI) subsidiary will be relocated to alternate

SEI facilities. Statement of Financial Accounting Standards No. 146 (SFAS 146), "Accounting for Costs Associated with Exit or Disposal Activities", applies to all disposal activities initiated after December 31, 2002 and prospectively nullifies EITF 94-3. SFAS 146 requires that a liability for employee termination costs associated with an exit or disposal activity be recognized when the liability is incurred. (EITF 94-3 had previously required that a liability for such costs be recognized at the date of the Company's commitment to an exit or disposal plan). In accordance with SFAS 146, the Company recorded restructuring expense of $1.2 million in the quarter ended April 30, 2003 and anticipates that it will record an additional $1.8 million of restructuring expense related to this plan, substantially all of which will be recorded during the year ending October 31, 2003. The plan will involve terminating 147 employees, none of which had been terminated as of April 30, 2003.

During the three months ended April 30, 2003, the Company recorded the following costs in connection with this restructuring plan.

	Expensed	Utilized	Accru at Apri 200
Severance and related benefits	$ 268	$	$ 2
Pension curtailment costs	35		
Estimated loss on asset disposal	890		
Total Restructuring Costs	$ 1,193		

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NOTE H - DISCONTINUED OPERATIONS

During the second quarter of 2002, the Company formally adopted a plan to dispose of Engineered Specialty Plastics, Inc. (ESP), a wholly-owned subsidiary representing the entirety of the Plastic Products business segment. The Company completed the sale of ESP in the quarter ended April 30, 2003 to a private equity group. Consideration received by the Company included $4.1 million of cash, a $3.3 million two-year note from the buyers secured by the real property of ESP, and contingent consideration based upon ESP's future revenues, net of a $0.3 million working capital adjustment payable by the Company. In conjunction with the intended disposition of ESP, the Company had previously recorded an estimated loss on disposal of discontinued operations of $4.2 million to reduce the carrying value of ESP's net assets to their estimated fair value less estimated selling costs. The completion of the sale resulted in no adjustment to this $4.2 million loss. The Company has reported the results of operations of ESP as discontinued operations for the three and six months ended April 30, 2003 and 2002 in the Condensed Consolidated Statements of Income. All assets and liabilities associated with ESP have been reclassified as assets and liabilities of discontinued operations on the October 31, 2002 Condensed Consolidated Balance Sheet. Certain information with respect to the discontinued operations of ESP for the three and six month periods ended April 30, 2003 and 2002 is as follows:

	Three Months Ended April 30	
	2003	2002
Net revenues	$ 4,010	$ 3,266
Income (loss) from operations, net of income tax	$ 157	$ (143)
Estimated loss on disposal, net of income tax		(3,145)
Income (loss) on discontinued operations, net of income tax	$ 157	$(3,288)

Certain information with respect to the assets and liabilities of ESP is summarized as follows:

	October 31 2002
Accounts receivable	$ 4,750
Inventories	5,329
Property, plant and equipment	1,308
Assets of Discontinued Operations	$11,387
Accounts payable	$ 3,354
Accrued expenses and other liabilities	439
Liabilities of Discontinued Operations	$ 3,793

NOTE I - NOTES PAYABLE

Effective April 23, 2003, the Company retired all borrowings under its existing credit facility and entered into a new bank agreement which provided a $125 million unsecured, revolving credit facility. Borrowings under the new agreement, which expires April 23, 2007, are subject to interest, at the Company's option, at either the Eurodollar rate plus an applicable margin or at the prime rate plus an applicable margin. The margin applicable to the Eurodollar rate varies from 0.875% to 1.625% and the margin applicable to the prime rate varies from 0.0% to 0.25% depending upon the Company's ratio of total indebtedness to earnings before interest, taxes, depreciation and amortization (leverage ratio). As of April 30, 2003, the Company had borrowings of $15.0 against the new revolving credit facility.

NOTE J - CONTRACTS IN PROCESS AND INVENTORIES

Contracts in process and inventories of certain of the Company's operating subsidiaries (Systems & Electronics Inc., Engineered Air Systems, Inc., Keco Industries, Inc., Engineered Electric Company and Radian, Inc.) represent accumulated contract costs, estimated earnings thereon based upon the percentage of completion method and contract inventories reduced by the contract value of delivered items. Inventories of Engineered Coil Company and Universal Power Systems, Inc. are valued at the lower of cost or market using the first-in, first-out method. Contracts in process and inventories are comprised of the following:

	April 30, 2003	October 31, 2002
Raw materials	$ 3,011	$ 3,662
Work-in-process	1,250	2,368
Finished goods	108	178
Inventories substantially applicable to government contracts in process, less Progress payments of $55,060 and $55,809	18,921	35,974
	$ 23,290	$ 42,182

NOTE K - SEGMENT INFORMATION

The Company operates in three business segments: Light Military Support Equipment, Heavy Military Support Equipment, and Electronics and Automation Systems. The Light Military Support Equipment segment engineers and manufactures a broad range of military support equipment primarily for the DoD, as well as related heat-transfer and air-handling equipment for domestic commercial and industrial users. The segment also provides engineering services and asset protection / security systems to the DoD and other government customers. Segment products include environmental control systems, generator sets and related power generation and distribution systems, chemical and biological protection systems, petroleum and water systems and other multipurpose military support equipment. The Heavy Military Support Equipment segment engineers and manufactures load management and

transport systems primarily for the DoD. The Electronics and Automation Systems segment engineers and manufactures airborne radar systems, reconnaissance, surveillance and target acquisition systems and avionics test equipment primarily for the DoD. The segment also engineers and manufactures material-handling equipment primarily for the U.S. Postal Service. Inter-segment revenues for the three and six months ended April 30, 2003 and 2002, respectively, were not significant. Total assets by segment as disclosed in the Company's annual report for the year ended October 31, 2002 have not changed materially since that date. Goodwill by segment as of October 31, 2002 totaled $53,725 for Light Military Support Equipment, $23,086 for Heavy Military Support Equipment and $26,633 for Electronics and

Automation Systems. Goodwill by segment as of April 30, 2003 totaled $58,733 for Light Military Support Equipment, $23,086 for Heavy Military Support Equipment and $26,633 for Electronics and Automation Systems. In addition, there have been no changes in either the basis of segmentation or the measurement of segment income since October 31, 2002. Information by segment is as follows:

	Three Months Ended April 30		Six Mo Ap
	2003	2002	2003
Net revenues:			
Light military support equipment	$ 68,556	$37,379	$137,493
Heavy military support equipment	31,494	34,421	62,643
Electronics and automation systems	25,007	19,980	46,584
Total	$125,057	$91,780	$246,720
Operating income from continuing operations:			
Light military support equipment	$ 7,556	$ 4,350	$ 13,674
Heavy military support equipment	4,316	5,664	9,653
Electronics and automation systems	2,251	1,443	5,035
	14,123	11,457	28,362
Interest expense	(271)	(756)	(727)
Interest income	48	60	97
Gain on sale of assets			6
Income from continuing operations before income taxes	$ 13,900	$10,761	$ 27,738

NOTE L - SUBSEQUENT EVENT

Effective May 1, 2003, the Company acquired all of the outstanding stock of Technical and Management Services Corporation (TAMSCO), a provider of information technology logistics and digitization services and a designer and integrator of telecommunication systems primarily for the U.S. Department of Defense. The purchase price was $66.5 million in cash, which the Company financed with short-term borrowings under its revolving credit facility.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

CRITICAL ACCOUNTING POLICIES

Revenues on long-term contracts performed within the Company's Light Military Support Equipment, Heavy Military Support Equipment and

Electronics and Automation Systems segments, substantially all of which are with the U.S. Government, are recognized under the percentage-of-completion method and include a proportion of the earnings that are expected to be realized on the contract in the ratio that production measures, primarily labor, incurred bear to the estimated production measures for the contract. Earnings expectations are based upon estimates of contract values and costs at completion. Contracts in process are reviewed on a periodic basis. Adjustments to revenues and earnings are made in the current accounting period based upon revisions in contract values and estimated costs at completion. Amounts representing contract change orders, claims and other items are included in revenues, as recognized under the percentage-of-completion method, only when these amounts can be reliably estimated and realization is probable. Provisions for estimated losses on contracts are recorded when identified.

During the second quarter of 2002, the Company formally adopted a plan to dispose of Engineered Specialty Plastics, Inc. (ESP), a wholly-owned subsidiary representing the entirety of the Plastic Products business segment. In conjunction with this plan, the Company recorded an estimated loss on disposal to reduce the carrying value of ESP's net assets to their estimated fair value less estimated selling costs. Accordingly, the Company has reported the results of operations of ESP as discontinued operations for the three and six months ended April 30, 2003 and 2002 in the Condensed Consolidated Statements of Income. Additionally, all depreciation on the property, plant and equipment of ESP was suspended as of the end of the second quarter of 2002. The Company completed the sale of ESP in the second quarter of 2003 with no resulting adjustment to the estimated loss on disposal.

During the third quarter of 2002, the Company announced a restructuring plan to improve both plant utilization and long-term profitability. Under the plan, the Company's Blue Ash, Ohio and Olivette, Missouri manufacturing locations will be closed during the year ending October 31, 2003 with related production efforts being relocated to other existing Company facilities. Emerging Issues Task Force No. 94-3 (EITF 94-3) provided specific requirements as to the appropriate recognition of restructuring costs associated with employee termination benefits and other exit costs. Employee termination costs are recognized when benefit arrangements are communicated to affected employees in sufficient detail to enable the employees to determine the amount of benefits to be received upon termination. Other costs resulting from the restructuring plan that are not associated with or that do not benefit activities that will be continued are recognized at the date of commitment to the plan subject to certain conditions. For the cost to be accrued, it must not be associated with or incurred to generate revenues after the commitment date and must be either incremental to other costs incurred prior to the commitment date, or represent amounts under a contractual obligation that existed prior to the commitment date that will either continue after the plan is completed with no economic benefit or which will result in a penalty to cancel the obligation. Other costs directly

related to the restructuring plan which are not eligible for recognition at the commitment date, such as relocation and other integration costs, are expensed as incurred.

During the quarter ended April 30, 2003, the Company announced an additional restructuring plan under which the electronics assembly work

currently performed at the Company's Sanford, Florida facility of its Systems & Electronics Inc. (SEI) subsidiary will be relocated to alternate SEI facilities. Statement of Financial Accounting Standards No. 146 (SFAS 146), "Accounting for Costs Associated with Exit or Disposal Activities", applies to all disposal activities initiated after December 31, 2002 and prospectively nullifies EITF 94-3. SFAS 146 requires that a liability for employee termination costs associated with an exit or disposal activity be recognized when the liability is incurred. (EITF 94-3 had previously required that a liability for such costs be recognized at the date of the Company's commitment to an exit or disposal plan).

The following analysis should be read in this context.

RESULTS OF OPERATIONS

Consolidated net revenues from continuing operations increased $33.3 million, or 36.3%, to $125.1 million in the second quarter of 2003 compared to $91.8 million in the second quarter of 2002. This increase was primarily the result of $26.4 million of net revenues from Radian, Inc. (Radian), which was acquired May 10, 2002, and from Universal Power Systems, Inc. (UPSI), which was acquired June 27, 2002. Radian's most significant contract, the Deployable Power Generation and Distribution System (DPGDS) for the U.S. Air Force and U.S. Army contributed $13.3 million in revenues during the quarter ended April 30, 2003. All other operating subsidiaries contributed a combined 7.5% increase in net revenues during the quarter. Gross profit from continuing operations for the three months ended April 30, 2003 increased $8.0 million, or 36.9%, to $29.8 million (23.8% of consolidated net revenues) from $21.8 million (23.7% of consolidated net revenues) in the comparable 2002 period. The increase in gross profit was a result of the significant increase in net revenues. Selling, general and administrative expense from continuing operations increased $4.2 million, or 40.4%, in the second quarter of 2003 to $14.5 million (11.6% of consolidated net revenues) from $10.3 million (11.3% of consolidated net revenues) in the second quarter of 2003. In addition, the Company recorded a restructuring expense of $1.2 million in the quarter ended April 30, 2003 related to its announced plan to relocate electronics assembly work currently performed at the Company's Sanford, Florida facility of its Systems & Electronics Inc. (SEI) subsidiary to alternate SEI facilities. As a result of the above, income from continuing operations increased $2.7 million or 23.3% in the quarter ended April 30, 2003 to $14.1 million from $11.5 million in the second quarter of 2002.

Consolidated net revenues from continuing operations increased $63.6 million, or 34.8%, to $246.7 million in the six months ended April 30, 2003 compared to $183.1 million in the first half of 2002. This increase was primarily the result of $55.3 million of net revenues from Radian and UPSI. All other operating subsidiaries contributed a combined 4.5% increase in net revenues during the six month period. Gross profit from continuing operations for the six

months ended April 30, 2003 increased $15.2 million, or 36.6%, to $56.9 million (23.1% of consolidated net revenues) from $41.7 million (22.8% of consolidated net revenues) in the comparable 2002 period. Selling, general and administrative expense from continuing operations increased $7.7 million, or 39.0%, in the first half of 2003 to $27.4 million (11.1% of consolidated net revenues) from $19.7 million (10.8% of consolidated net

revenues) in the prior year. As a result of the above and of the $1.2 million restructuring expense discussed above, income from continuing operations increased $6.4 million, or 29.1%, in the six months ended April 30, 2003 to $28.4 million from $22.0 million in the first half of 2002.

LIGHT MILITARY SUPPORT EQUIPMENT. Net revenues for the Light Military Support Equipment segment increased by $31.2 million, or 83.4%, to $68.6 million in the second quarter of 2003 from $37.4 million in the second quarter of 2002 primarily due to the addition of $26.4 million in net revenues from Radian and UPSI. All other operating subsidiaries within the segment contributed a combined 12.8% increase in net revenues during the quarter. For the six months ended April 30, 2003, net revenues for the segment increased by $60.5 million, or 78.7%, to $137.5 million from $77.0 million in the first half of 2002. Radian and UPSI accounted for $55.3 million of this increase. Gross profit for the segment increased by $7.3 million, or 88.5%, in the second quarter of 2003 to $15.6 million (22.8% of segment net revenues) from $8.3 million (22.2% of segment net revenues) in the second quarter of 2002. Likewise, gross profit for the segment increased by $12.1 million, or 69.1%, in the six months ended April 30, 2003 to $29.5 million (21.4% of segment net revenues) from $17.4 (22.6% of segment net revenues) in the first half of 2002. Income from operations increased by $3.2 million, or 73.7%, in the second quarter of 2003 to $7.6 million from $4.4 million in the second quarter of 2002, and increased by $4.0 million, or 41.0%, in the first half of 2003 to $13.7 million from $9.7 million in the first half of 2002.

HEAVY MILITARY SUPPORT EQUIPMENT. Net revenues for the Heavy Military Support Equipment segment decreased by $2.9 million, or 8.5%, to $31.5 million in the second quarter of 2003 from $34.4 million in the second quarter of 2002. This decrease was primarily due to the completion of deliveries for the M1000 semi-trailer in March 2003. M1000 contract revenues totaled $4.1 million in the second quarter of 2003 compared to $7.0 million in the quarter ended April 30, 2002. For the six months ended April 30, 2003, net revenues for the segment decreased by $2.8 million, or 4.3%, to $62.6 million from $65.4 million in the first half of 2002, also due to completion of the M1000 contract. Gross profit for the segment decreased by $1.8 million, or 18.2%, in the second quarter of 2003 to $7.9 million (25.2% of segment net revenues) from $9.7 million (28.2% of segment net revenues) in the second quarter of 2002. For the six months ended April 30, 2003, gross profit for the segment was $16.4 million (26.2% of segment net revenues), which was unchanged from $16.4 million (25.0% of segment revenues) in the first six months of 2002. Income from operations decreased by $1.4 million, or 23.8%, to $4.3 million in the second quarter of 2003 from $5.7 million in the second quarter of 2002, and increased by $0.7 million, or 7.8%, in the first half of 2003 to $9.7 million from $9.0 million in the first half of 2002.

ELECTRONICS AND AUTOMATION SYSTEMS. Net revenues for the Electronics and Automation Systems segment increased by $5.0 million, or 25.2%, to $25.0 million in the second quarter of 2003 from $20.0 million in the second quarter of 2002. This increase was

primarily due to additional revenues from the Knight reconnaissance / surveillance / target acquisition program and higher demand for the segment's MSTAR radar product. For the six months ended April 30, 2003, net revenues for the segment increased by $5.9 million, or 14.6%, to $46.6 million from $40.7 million in the first half of 2002. Gross profit for the

segment increased $2.4 million, or 65.2%, in the second quarter of 2003 to $6.2 million (24.9% of segment net revenues) from $3.8 million (18.9% of segment net revenues) in the second quarter of 2002. For the six months ended April 30, 2003, gross profit for the segment increased $3.2 million, or 40.5%, to $11.1 million (23.8% of segment net revenues) from $7.9 million (19.4% of segment net revenues) in the first half of 2002. Increases in gross profit and gross margin for the segment were a result of higher revenue levels and a more favorable product mix. Income from operations increased by $0.8 million, or 56.0%, in the second quarter of 2003 to $2.3 million from $1.5 million in the second quarter of 2002, and increased by $1.7 million, or 51.5%, in the first half of 2003 to $5.0 million from $3.3 million in the first half of 2002. Increases in income from operations were a result of significant gains in gross profit, offset by a $1.2 million restructuring expense in both the quarter and six months ended April 30, 2003.

Net interest expense decreased by $0.5 million to $0.2 million in the second quarter of 2003 and by $0.9 million to $0.6 million in the six months ended April 30, 2003. These decreases were a result of lower outstanding borrowings, as well as the impact of lower interest rates. The effective income tax rate was 39.0% for the three and six month periods ended April 30, 2003 and 2002. As a result of the foregoing, net income from continuing operations increased 29.2% to $8.5 million (6.8% of consolidated net revenues) in the quarter ended April 30, 2003 as compared to $6.6 million (7.2% of consolidated net revenues) in the second quarter of 2002. For the six months ended April 30, 2003, net income from continuing operations increased 35.7% to $16.9 million (6.9% of consolidated net revenues) from $12.5 million (6.8% of consolidated net revenues) for the first half of 2002.

During the second quarter of 2002, the Company formally adopted a plan to dispose of ESP. The Company completed the sale of ESP in the quarter ended April 30, 2003 to a private equity group. In conjunction with the intended disposition of ESP, the Company had previously recorded an estimated loss on disposal of discontinued operations of $4.2 million, $3.2 million of which was recorded in the quarter ended April 30, 2002. The completion of the sale resulted in no adjustment to this $4.2 million loss. In addition, the Company realized income (loss) from ESP operations, net of income tax, of $0.2 million and $(0.1) million in the second quarter of 2003 and 2002, respectively, and of $0.3 million and $(0.5) million in the six months ended April 30, 2003 and 2002, respectively.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". SFAS 144 addresses the financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes SFAS 121. The Company adopted SFAS 144 effective November 1, 2001. The Company has accounted for the disposition through sale of ESP as discontinued operations in accordance with SFAS 144.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities". SFAS 146 provides direction for accounting and disclosure regarding specific costs related to an exit or disposal activity. These include, but are not limited to, costs to terminate a contract that is not a capital lease, costs to consolidate facilities or relocate employees, and certain termination benefits provided to employees

that are involuntarily terminated under the terms of a one-time benefit arrangement. The Company adopted SFAS 146 effective January 1, 2003.

In December 2002, the FASB issued SFAS 148, "Accounting for Stock Based Compensation - Transition and Disclosure - an Amendment of SFAS 123." SFAS 148 provides additional transition guidance for those entities that elect to voluntarily adopt the provisions of SFAS 123, "Accounting for Stock Based Compensation." Furthermore, SFAS 148 mandates new disclosures in both interim and year-end financial statements within the Company's Significant Accounting Policies footnote. The Company adopted these disclosure requirements for the year ended October 31, 2002 and has applied them to its interim financial statements in 2003.

In November 2002, the FASB issued Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN 45 clarifies disclosures regarding certain guarantees to be made by a guarantor in its interim and annual financial statements. FIN 45 also clarifies that a guarantor is required to recognize, at the inception of certain guarantees, a liability for the fair value of the obligation undertaken in issuing the guarantee, but does not prescribe a specific approach for subsequently measuring the liability over its life. Recognition provisions of FIN 45 are to be applied prospectively for guarantees issued or modified after December 31, 2002. The related disclosure requirements are effective for periods ending after December 15, 2002. The Company adopted FIN 45 for the quarter ended January 31, 2003.

LIQUIDITY AND CAPITAL RESOURCES

On April 16, 2003, the Company completed the sale of ESP to a private equity group. Consideration received by the Company included $4.1 million of cash, a $3.3 million two-year note from the buyers secured by the real property of ESP, and contingent consideration based upon ESP's future revenues, net of a $0.3 million working capital adjustment payable by the Company.

Effective April 23, 2003, the Company retired all borrowings under its existing credit facility and entered into a new bank agreement which provided a $125 million unsecured, revolving credit facility. Borrowings under the new agreement, which expires April 23, 2007, are subject to interest, at the Company's option, at either the Eurodollar rate plus an applicable margin or at the prime rate plus an applicable margin. The margin applicable to the Eurodollar rate varies from 0.875% to 1.625% and the margin applicable to the prime rate varies from 0.0% to 0.25% depending upon the Company's ratio of total indebtedness to earnings before interest, taxes, depreciation and amortization (leverage ratio). As of April 30, 2003, the Company had borrowings of $15.0 million against the new revolving credit facility and a cash balance of $14.9 million.

Effective May 1, 2003, the Company acquired all of the outstanding stock of Technical and Management Services Corporation (TAMSCO), a provider of information technology logistics and digitization services and a designer and integrator of telecommunication systems primarily for the U.S. Department of Defense. The purchase price was $66.5 million in cash, which the Company financed with short-term borrowings under its revolving credit facility.

At April 30, 2003, the Company's working capital and ratio of current assets to current liabilities were $13.5 million and 1.16 to 1 as compared with $17.6 million and 1.18 to 1 at October 31, 2002. The Company generated cash flow from continuing operations of $49.2 million in the six months ended April 30, 2003 as compared to $29.0 million in the first six months of 2002. Investment in property, plant and equipment totaled $5.3 million and $1.7 million for the first six months of 2003 and 2002, respectively. $3.4 million of total capital expenditures for the six months ended April 30, 2003 were incurred at the Company's Keco Industries, Inc. subsidiary and relate to the Company's previously discussed restructuring plan. The Company anticipates that capital expenditures in 2003 should not exceed $7.0 million. Management believes that cash flow generated from operations, together with the available line of credit, will provide the necessary resources to meet the needs of the Company in the foreseeable future.

There have been no material changes in the total contractual and contingent obligations included in the Company's annual report to shareholders for the year ended October 31, 2002.

BUSINESS AND MARKET CONSIDERATIONS

Approximately 95% of consolidated net revenues from continuing operations for the six months ended April 30, 2003 were directly or indirectly derived from defense orders by the U.S. government and its agencies. As of April 30, 2003, the Company's funded backlog of orders totaled $431.0 million, with related customer options of an additional $658.3 million.

Management continues to pursue potential acquisitions, primarily of those companies providing strategic consolidation within the defense industry such as TAMSCO.

FORWARD-LOOKING STATEMENTS

In addition to historical information, this report includes certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which are intended to be covered by the safe harbors created thereby. The forward-looking statements involve certain risks and uncertainties, including, but not limited to acquisitions, additional financing requirements, the decision of any of the Company's key customers (including the U.S. government) to reduce or terminate orders with the Company, cutbacks in defense spending by the U.S. government and increased competition in the Company's markets, which could cause the Company's actual results to differ materially from those projected in, or inferred by, the forward-looking statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

At October 31, 2002, the Company's derivative contracts consisted only of interest rate swaps used by the Company to convert a portion of its variable rate long-term debt to fixed rates. These contracts expired in November 2002. At April 30, 2003, the Company had no derivative contracts.

ITEM 4. CONTROLS AND PROCEDURES.

Within the 90 days prior to the filing date of this report, 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 Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as defined in Rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based upon the evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in Company reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There have been no significant changes in the Company's internal controls or in other factors that could significantly affect those controls subsequent to the date this evaluation was carried out, including any corrective actions with regard to significant deficiencies and material weaknesses.

PART II
OTHER INFORMATION

Items 1-5 Not applicable.

Item 6 Exhibits and Reports on Form 8-K.

(a) Exhibits

4. Credit Agreement dated as of April 23, 2003 among Engineered Support Systems, Inc., Bank of America, N.A. and the Other Lenders Party Hereto

10. Employment Agreement with Gerald E. Daniels dated April 1, 2003

11. Statement Re: Computation of Earnings Per Share

99.1 Certification of Chief Executive Officer

99.2 Certification of Chief Financial Officer

(b) During the quarter ended April 30, 2003, the Company filed the following reports on Form 8-K:

(1) Form 8-K dated March 6, 2003 regarding announcement of a non-binding letter of intent to purchase all of the outstanding stock of Technical and Management Services Corporation (TAMSCO).

(2) Form 8-K dated April 2, 2003 regarding the Company's restructuring plan for its Sanford, Florida

facility.

(3) Form 8-K dated April 21, 2003 regarding completion of of the sale of Engineered Specialty Plastics, Inc.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ENGINEERED SUPPORT SYSTEMS, INC.

Date: June 16, 2003 By: /s/ Gerald E. Daniels

Gerald E. Daniels
Vice Chairman and
Chief Executive Officer

Date: June 16, 2003 By: /s/ Gary C. Gerhardt

Gary C. Gerhardt
Vice Chairman and Chief
Financial Officer

CERTIFICATIONS

I, Gerald E. Daniels, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Engineered Support Systems, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statements of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as

defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a. Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b. Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and,

c. Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit and finance committee of the registrant's board of directors (or persons performing the equivalent functions):

a. All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and,

b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and,

6. The registrant's other certifying officer and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: June 16, 2003

/s/ Gerald E. Daniels

Gerald E. Daniels
Vice Chairman and Chief Executive Officer

CERTIFICATIONS

I, Gary C. Gerhardt, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Engineered Support Systems, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statements of a material fact or omit to state a material fact

necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

    a. Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

    b. Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and,

    c. Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit and finance committee of the registrant's board of directors (or persons performing the equivalent functions):

    a. All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and,

    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and,

6. The registrant's other certifying officer and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: June 16, 2003

/s/ Gary C. Gerhardt

Gary C. Gerhardt
Vice Chairman and Chief
Financial Officer