



Advancing

Defense

Transformation

Continued Growth Means

DRS Technologies is a leading supplier of defense electronics systems. We provide high-technology products and services to government and commercial customers worldwide. The Company develops and manufactures a broad range of mission critical systems and components in the areas of communications, combat systems, battlefield digitization, electro-optics, power systems, data storage, digital imaging, flight safety and space. Our defense electronics systems are sold to all branches of the U.S. military, government intelligence agencies, major aerospace and defense contractors, and international military forces. With a diversified portfolio of core defense programs, DRS Technologies has received significant new awards and expanded our program base through strategic acquisitions. These accomplishments are fundamental to building a great company. As a valued supplier for 34 years to the Department of Defense and major aerospace prime contractors, DRS is advancing defense transformation initiatives through the development of leading edge technologies for mission-critical electronic systems supporting the military's front-line ground, sea and air platforms.

Financial Highlights

(\$ in millions except per-share data)

Fiscal Year Ended March 31,	2003	Increase	2002	Increase	2001
Revenues	\$675.8	31%	\$517.2	21%	\$427.6
Operating income	\$ 67.7	36%	\$ 49.8	33%	\$ 37.5
Earnings before interest, taxes, depreciation and amortization (EBITDA)*	\$ 81.9	32%	\$ 62.0	18%	\$ 52.3
Net earnings	\$ 30.2	48%	\$ 20.3	70%	\$ 12.0
Net earnings per share					
Basic	\$ 1.64	8%	\$ 1.52	33%	\$ 1.14
Diluted	\$ 1.58	12%	\$ 1.41	40%	\$ 1.01
Stockholders' equity	\$438.2	70%	\$257.2	130%	\$111.9
Bookings	\$723.5	25%	\$577.2	21%	\$478.8
Backlog	\$867.1	46%	\$595.3	30%	\$456.5

* See Management's Discussion and Analysis of Financial Condition and Results of Operations, Use of Non-GAAP Financial Measures, for additional information regarding EBITDA.

*On the Cover: American troops from the U.S. Army's Third Division on the Iraq-Kuwait border, February 2003.
Photograph by Christopher Morris, VII.*

U.S. flag etiquette calls for the Union to always face the front of the soldier when the flag is worn as an arm patch. When worn as a patch on the right arm, this may give the appearance of the flag being backwards, but, in fact, is proper.



Integrated solutions
for customers



Building our
program portfolio in
growth areas



Increased partnering
with the military
and primes



Advancing the
military's defense
initiatives



DRS Technologies has grown to become an important partner with military and industry customers, expanding through acquisition and playing an increasingly vital role in national and international defense.

With the acquisition of Paravant Inc., DRS has become a world leader in tactical computer systems and integrated peripheral products for battlefield digitization. These systems support military Command, Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance (C4ISR) initiatives.

DRS's acquisitions of Eaton Corporation's Navy Controls Division, Kaman Corporation's Electromagnetics Development Center and Power Technology Incorporated have positioned the Company as a key power systems supplier for the Navy's backfit, modernization and transformational initiatives.



With our acquisition of the U.S. Unmanned Aerial Vehicle business of Meggitt Defense Systems, DRS has the opportunity to incorporate our core C4ISR, electro-optical system and other technologies onto UAVs for special military operations, homeland defense and force protection initiatives.



DRS's acquisition of Nytech Integrated Infrared Systems, Inc. increased our participation in the Army's Objective Force Warrior and other programs requiring lightweight thermal imaging for portable weapons, head gear, hand-held devices, vehicle sights, infrared cameras and sensor modules.



Dear Stockholders: Fiscal 2003 was an excellent year for DRS Technologies and a very active one. In our first year as a New York Stock Exchange-listed company, we achieved record financial results, booked more orders for products and services than in any other year and acquired six businesses. We also completed an equity offering that provided \$144.3 million of cash and expanded our credit facility at favorable rates to enhance our cash position and fuel our strategic plans for long-term growth.

These accomplishments, coupled with a defense spending outlook projected to increase over the next several years, are encouraging indicators that we can achieve our stated goals of double-digit annual revenue and operating income growth, well positioning the Company for the future. As we grow, we are building greater strength to capture an increasingly important role in supplying systems that advance our military customers' transformation initiatives.





The Senior Leadership Team

Left to right:

Richard A. Schneider, Executive Vice President, Chief Financial Officer;

Robert F. Mehmel, Executive Vice President, Business Operations and Strategy; **Nina L. Dunn**, Executive

Vice President, General Counsel and Secretary; **Paul G. Casner**, Executive Vice President, Chief Operating Officer;

Mark S. Newman, Chairman of the Board, President and Chief Executive Officer.

Revenues (in millions)



Operating Income (in millions)



Record Revenues

DRS reported outstanding results for the year ended March 31, 2003, achieving records in all for our major metrics.

Revenues were a record \$675.8 million, 31% higher than revenues of \$517.2 million generated last year. The addition of sales from two major acquisitions during the year, coupled with the benefit of full-year sales from our fiscal 2002 acquisition of the Sensors and Electronic Systems business of The Boeing Company, were the primary catalysts for the increase, and were supplemented with favorable organic revenue growth.

Record Earnings

Fiscal 2003 operating income of \$67.7 million represented a 36% increase over the \$49.8 million in operating income reported for fiscal 2002. Our operating margin rose to 10.0%, compared with 9.6% for the previous year, reflecting the addition of profitable programs associated with acquisitions.

Earnings before interest, taxes, depreciation and amortization (EBITDA) were \$81.9 million for fiscal 2003, 32% higher than EBITDA of \$62.0 million for last year. (See Management's Discussion and Analysis of Financial Condition and Results of Operations, Use of Non-GAAP Financial Measures, for additional information regarding EBITDA.)

Net earnings for the Company for fiscal 2003 were 48% higher than a year ago at \$30.2 million, or \$1.58 per diluted share, on 19.1 million diluted shares outstanding. Last year's net earnings were \$20.3 million, or \$1.41 per diluted share, on 14.5 million diluted shares outstanding. The 32% increase in diluted shares outstanding was due to our equity offering completed in December 2002, which placed approximately 5.5 million additional shares in the marketplace.

Record Bookings and Backlog

DRS captured a record \$723.5 million in new orders during fiscal 2003, 25% higher than last year, bringing funded backlog at March 31, 2003 to a new year-end high of \$867.1 million, 46% above backlog of \$595.3 million at the same time last year.

Our Electronic Systems Group (ESG) received a record \$344.8 million in new contracts during the year. Of this amount, orders of \$106.5 million were booked for Naval power systems. \$81.8 million in new awards related to engineering and production of combat display systems for U.S. Navy ships, aircraft and submarines. Contracts totaling \$76.1 million were associated with battlefield digitization products for the U.S. Army and international militaries, as well as computers for intelligence gathering applications.

Our Electro-Optical Systems Group (EOSG) captured a record \$272.2 million in new awards, with \$87.6 million related to advanced infrared aircraft sighting, targeting and weapons systems, and maritime infrared sensor systems. \$86.1 million was associated with U.S. Army and Marine Corps infrared sighting, targeting and fire control systems for front-line ground vehicles, such as the Abrams Main Battle Tanks, Bradley Fighting Vehicles and Long-Range Scouts. New awards for EOSG in fiscal 2003 also included \$62.0 million for detectors and sights for military weapons, soldier systems, remote sensors and electro-optical technology development.

DRS's Flight Safety and Communications Group (FSCG) reported \$105.4 million in new contracts for products and services. Bookings of \$40.8 million related to integrated naval ship and data link communications systems, as well as naval search and track systems, for U.S. and international military applications. Orders of \$33.5 million were associated with providing flight data recorders, mission recorders, high-speed digital cameras and other avionics systems. Contracts valued at \$27.5 million were received for advanced electronic manufacturing, test and system integration services supporting aerospace, defense and space-related applications.

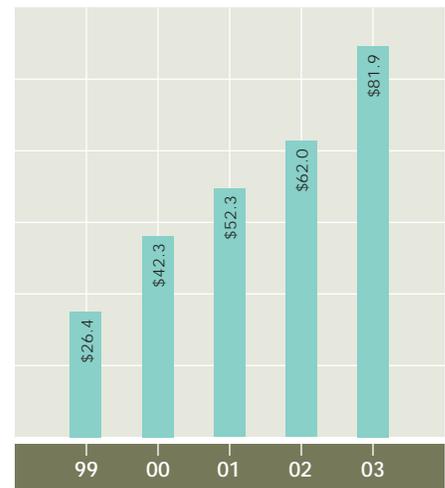
Increased Research and Development

To supply leading edge defense electronics systems to our customers and enhance our competitive posture, in fiscal 2003 we continued to place a strong emphasis on investing in technology development. Combined expenditures for research and development, both internal and customer-funded, climbed to \$58.1 million.

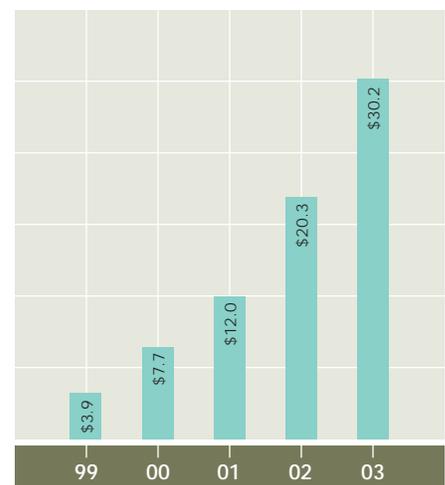
Operational Improvements

In fiscal 2003, we continued to evaluate the Company with an objective to consolidate facilities where possible and reduce costs for improved profitability and operational efficiencies. During the year, we consolidated two operations: DRS Data & Imaging Systems Ltd., formerly DRS Hadland Ltd., was moved from Tring, Hertfordshire, the United Kingdom to our existing DRS Tactical Systems Ltd. facility, formerly named DRS Rugged Systems (Europe) Ltd., in Farnham, Surrey, U.K. We also successfully completed the integration and transfer of several major programs associated with our fiscal 2002 acquisition of Boeing's Sensors and Electronic Systems business to existing DRS manufacturing plants in Melbourne, Florida and Dallas, Texas. And, we continued to benefit from other facility consolidations accomplished in fiscal 2002.

EBITDA (in millions)

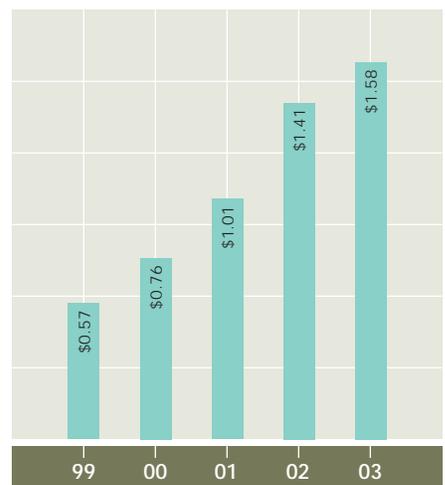


Net Earnings from Continuing Operations* (in millions)



*Before extraordinary item in fiscal 1999

Net Earnings per Share from Continuing Operations (Diluted)*



*Before extraordinary item in fiscal 1999

The evaluation and implementation of efficiencies in all of our operations is an ongoing process for us and an effective strategy for lowering costs.

Significant Developments

Acquisitions

Implementing a Strategy for Becoming a Leader in Power Systems

During fiscal 2003, we continued to pursue selective acquisition opportunities to enhance our growth and strategic position in the aerospace and defense industry.



Effective July 1, 2002, we acquired the Navy Controls Division of Eaton Corporation and began to implement our three-pronged strategy to become a leader in the Naval power systems market.

Renamed DRS Power & Control Technologies, this new ESG unit is a leading supplier of high-performance power conversion, distribution, propulsion and control systems for the U.S. Navy's combatant fleet, including nuclear-powered and conventionally-powered ships and submarines, and

also markets to specialized industrial customers. This acquisition, combined with our presence in Naval combat systems, has made DRS a preeminent total ship computing systems provider, with products on board virtually every ship and submarine in the U.S. Navy's fleets.

Through this acquisition, DRS captured key positions on next generation transformational Naval programs, including the Virginia class submarine, the CVN-21 future aircraft carrier and the DD(X) destroyer.

Left to right:

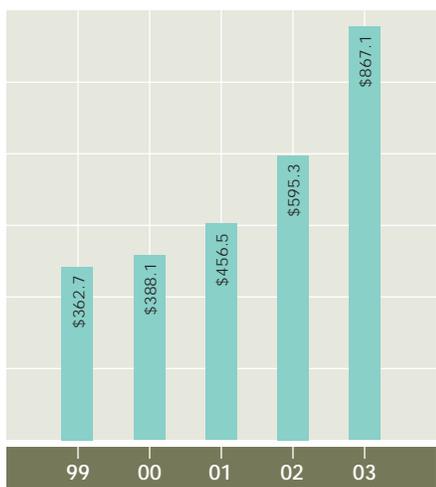
Jonathan T. Mann, Vice President, Corporate Counsel; **Audrey S. Stern**, Vice President, Corporate Counsel; **Thomas P. Crimmins**, Vice President, Controller; **Andrea J. Hayward**, Vice President, Human Resources; **Donald G. Hardman**, Treasurer; **Alan Gross**, Vice President, Contracts and Compliance.



Bookings (in millions)



Backlog (in millions)



With a heritage stemming from the combination of two legacy companies, Cutler-Hammer, Inc. and Consolidated Controls Corporation, DRS Power & Control Technologies has provided products to the Navy for nearly a century.

Building on this entrée into the Naval power systems business, in January and February, 2003, DRS acquired the Electromagnetics Development Center of Kaman Corporation and Power Technology Incorporated, and completed our strategy for positioning the Company as the primary U.S. power systems supplier capable of providing totally integrated electric or mechanical drive ship propulsion plants. These two acquisitions contributed high-performance, lightweight electric motors, generators and drive electronics, strengthening our existing power systems base. The combination of all three acquisitions has made DRS a key subcontractor to Northrop Grumman Ship Systems and Newport News Shipbuilding, as well as Rolls-Royce, on the U.S. Navy's new DD(X) program for the packaged gas turbine generators, propulsion motors, power electronics and other elements

of the electric drive engineering development models.

Our unique market position in power systems is expected to provide great returns, as we seek to expand onto other electric drive platforms supporting the Navy's shipbuilding initiatives, such as the CG(X) cruiser and Littoral Combat Ship (LCS) programs.

Building Strength in Tactical Systems for Battlefield Digitization

On November 27, 2002, we completed the acquisition of Paravant Inc., a leading producer of battle-ready defense electronics for U.S. and allied international military and intelligence agency applications.

Providing rugged computer systems, peripherals and communications interfaces for military Command, Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance (C4ISR) initiatives, the addition of Paravant to our existing product base made DRS a world leader in systems supporting digitization of the battlefield. With this acquisition, DRS became the leading supplier of battlefield computers for two large, long-term programs – the U.S. Army's Force XXI Battle Command, Brigade and Below (FBCB2) and the United Kingdom's BOWMAN programs. Incorporating the

latest developments in digital information processing and networking, these systems provide improved combat support throughout the force structure at the soldier, weapons and platform levels, assuring a seamless flow of battle command information to U.S. and British forces.

This transaction complemented our existing position on the U.S. Army's Common Hardware/Software 2 (CH/S-2) program and enhanced our competitive posture to capture future related programs.

Enhancing Our Position in Uncooled Infrared Systems

On October 15, 2002, we acquired Nytech Integrated Imaging Systems, Inc., a leader in uncooled thermal imaging systems used for portable soldier weapons, head gear, hand-held devices, Forward Looking Infrared (FLIR) cameras, vehicle-mounted sights, and lightweight gimbals that control numerous sensors on a variety of land, sea and air platforms. This acquisition expanded our pursuit of emerging electro-optical system programs promoting lighter weight, uncooled infrared sensors for low-cost military and commercial applications, which are revolutionizing the thermal imaging systems market.

Our DRS Nytech unit strongly complements our core electro-optical systems base and our entrée into the uncooled infrared market place with our fiscal 2002 acquisition of Boeing's Sensors and Electronic Systems business.

Prior to the transaction, DRS worked closely with Nytech through teaming arrangements, which culminated in the award of a number of strategically important military uncooled sensor programs, including the Bradley Head Tracked Sensor Suite (HTSS) and Cost Effective Targeting System (CETS) programs. These opportunities highlighted the strategic fit of both companies and the benefits of combining operations.

All of these transactions contributed revenue growth and earnings accretion in fiscal 2003.

Entering the Growing UAV Market

Early in the fiscal year, we acquired the U.S. UAV business of Meggitt Defense Systems - Texas, Inc. and entered the growing UAV marketplace with close-range, low-weight, low-noise, medium-duration UAVs for military special operations. Applications for these systems include tactical surveillance, radio relay and C4ISR. The incorporation onto our UAV platforms of our core technologies in

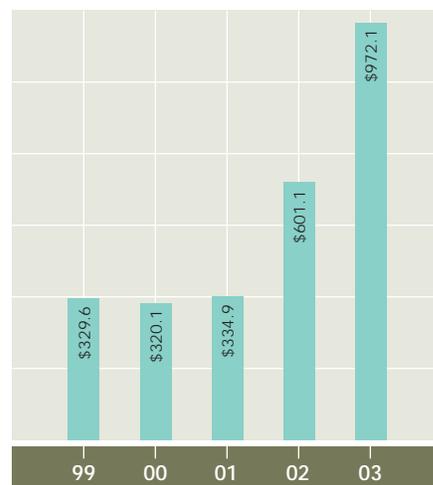
Book Value Per Share



Free Cash Flow (in millions)



Total Assets (in millions)





Letter to Stockholders

computer display systems, infrared sensors and targeting systems, high-speed digital cameras, data recording and communications systems are expected to contribute to the growth of this business.

Divestitures

During fiscal 2003, we sold our DRS Ahead Technology and DRS Advanced

Programs units as part of a strategic decision to concentrate our focus and resources on our core defense businesses. These businesses generated less than 5% of our fiscal 2002 revenues.

Strong Cash Position

During fiscal 2003, we expanded our credit facility by \$100 million and amended it at more favorable rates. On December 20, 2002, we completed a follow-on equity offering that placed



an additional 5.5 million shares of DRS common stock in the marketplace, which resulted in \$144.3 million in cash. These transactions provided cash to repay debt, acquire several businesses and strengthen our balance sheet.

Fiscal 2003 free cash flow was \$30.5 million, more than double the \$14.3 million for fiscal 2002. (See Management's Discussion and Analysis of Financial Condition and Results of Operations, Use of Non-GAAP Financial Measures, for additional information regarding free cash flow.) At year end, we had \$95.9 million in cash and cash equivalents in short-term investments. We intend to continue to utilize our cash and credit position for corporate purposes, including potential future acquisitions.

Left to right:

Louis J. Belsito, Vice President, Chief Information Officer; **Christopher Wright**, Vice President, Business Planning; **Mark J. Williams**, Senior Vice President, Human Resources; **Patricia M. Williamson**, Vice President, Corporate Communications/ Investor Relations; **Robert Russo**, Senior Vice President, Operations; **Michael L. Bowman**, Senior Vice President, Washington Operations.



Net Stockholders' Equity (in millions)



Weighted Average Diluted Shares Outstanding (in millions)



Leadership Additions

We were pleased to welcome a number of exceptional individuals to our leadership team during fiscal 2003.

Recently, we announced that Steven T. Schorer joined DRS as President of our Electronic Systems Group. Steve's 20 years of experience in the aerospace and defense industry and his diverse background in general management, international business development, program management and engineering will be of great assistance to us, as we increase our role in the military's transformational goals.

During fiscal 2003, Mark J. Williams joined the Company as Senior Vice President, Human Resources. In this capacity, Mark is focusing on organizational and leadership development, as well as strategic human resource initiatives throughout the Corporation. Mark's contributions are concentrated on maximizing the strengths and talents of our workforce, as we continue to integrate acquisitions and expand in size, complexity and employee diversity.

Donald G. Hardman joined DRS as Treasurer, establishing this position as full time to support the Company's growth. Don is concentrating on financial management strategies to

support DRS's growth, ensuring effective oversight of DRS's assets, maintenance of banking and credit relationships, and solutions for alternative financing.

Adding depth to our Corporate legal team, we also welcomed Jonathan T. Mann as Vice President, Corporate Counsel. His experience in general corporate legal counsel, merger and acquisition analysis, and negotiation and analysis of contracts and strategic alliances is serving us well.

Industry Recognition

DRS was pleased to accept the 2002 Herschel Award for our Vertically Integrated Photodiode and High Density Vertically Integrated Photodiode (HDVIP®) infrared detector technology. This prestigious award underscores the leadership position of our Electro-Optical Systems Group in high-performance infrared detection, which contributes to the strategic responsiveness, forward engagement and force projection capabilities of our military forces. The importance of this technology to the emerging needs of future missile warning and defense systems was a significant factor in our selection.

We also were delighted to receive Silver-Level Preferred Supplier Certification from The Boeing Company,

which recognized our Flight Safety and Communications Group for product quality and on-time delivery. This award highlights the total commitment we have to our customers and is a milestone in our progress toward continued product improvement.

DRS was recognized for several other quality achievements during the fiscal year, including the Aerospace Standard 9100 award and the Boeing Quality Management System award.

Outlook

Increases in defense spending over the next several years and continued funding for high-end defense electronics systems supporting military modernization and transformation programs are providing excellent growth opportunities for DRS and are supporting our positive outlook through fiscal 2004 and beyond.

We provide many systems and technologies considered essential for military initiatives focused on transformation, modernization and national security. Recent events have demonstrated the critical importance of maintaining a superior military force through advanced technology. Our continued participation in key areas of interest in the defense community, in combination with our disciplined approach to growing through

acquisitions in an environment where many potentially suitable opportunities exist, encourages our optimism for our future.

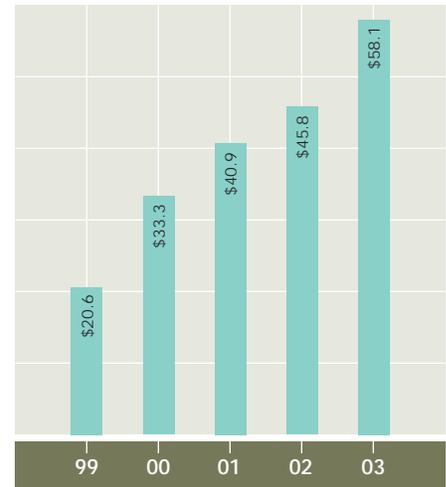
As a valued supplier to the Department of Defense and major aerospace prime contractors for 34 years, DRS remains stalwart in our commitment to provide our forces with the highest quality defense electronic systems that improve operations, increase survivability and ensure mission success.

We at DRS appreciate your continued support and loyalty.

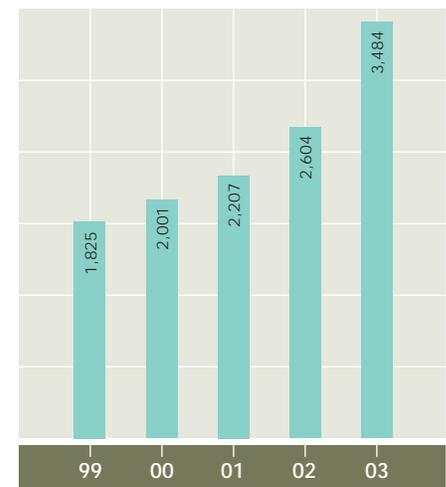


Mark S. Newman
*Chairman of the Board,
 President and Chief Executive Officer*

Research and Development (in millions)



Employees





Electronic Systems Group

- 1 DRS produces command and control workstations for Navy Hawkeye aircraft, signal processors for SIGINT applications on Air Force Rivet Joint aircraft and many other air systems.
- 2 DRS is providing electric drive equipment design for the Navy's next generation CVN-21 future aircraft carrier.
- 3 DRS produces radar systems and support products for U.S. Navy Aegis and international ships, carriers, amphibious operation platforms and NATO ground applications.
- 4 DRS's Multi-Display Workstations have up to 4 smart display computers to address future reduced manning and multi-security issues.
- 5 DRS is a total ship computing systems provider to the U.S. Navy for power conversion, distribution and propulsion systems, networks, tactical displays and nuclear plant controls.



6 DRS provides mobile Coastal and Harbor Surveillance Systems to protect shorelines from intruding threats.

7 DRS produces tactical computer systems and integrated peripherals for major U.S. Army and U.K. battlefield digitization programs supporting sea, air and land transformation applications.

8 DRS is focused on developing a network-centric computing infrastructure for next generation Navy platforms, like the CVN-21, DD(X) and LCS.

9 DRS is producing key elements of the electric drive system for the EDMs of the Navy's new DD(X) destroyer.

10 DRS manufactures every tactical display workstation on the UYQ-70 program being installed on U.S. Navy Aegis ships, submarines and aircraft.

11 DRS provides nuclear power conversion and control equipment to the Navy's submarine and aircraft carrier forces, including the Virginia class submarines.



Steven T. Schorer
Group President

DRS Technologies is a leading provider of computing, electronic surveillance and power systems for U.S. and international militaries. We specialize in the development, production and support of combat computer systems, networks, power systems and sensors for sea, air and land applications. Systems built by the Electronic Systems Group operate throughout the world on board front-line U.S. Navy Aegis class surface ships, attack submarines, aircraft carriers, surveillance aircraft and amphibious operations platforms. DRS's power equipment has operated on board every surface and submarine combatant ship built since World War II. And, computer systems built by the Electronic Systems Group are essential elements of the digital battlefield for both U.S. and British Armies.

Our products have been designed to provide modern processing technology that can operate under harsh battlefield conditions. Through programs such as the Common Hardware/Software II (CH/S-2) program, Force XXI Battle Command, Brigade and Below (FBCB2) program and the Movement Tracking System (MTS), DRS is providing the computing infrastructure that is enabling the transformation of the U.S. Army. Similarly, we are supporting the modernization of the British military by supplying User Data Terminals for the BOWMAN program.

DRS's Electronic Systems Group utilizes leading edge commercial computing technology to provide cost-effective system solutions for enhancing the military's ability to attain information dominance of the digital battle space. Designed to provide compatibility and interoperability with new and legacy systems, our products are vital links in the military's network-centric future. Our advanced electronic sensor and display systems provide U.S. and allied forces with a clear advantage by promoting real-time situational awareness, command and control and communications. Offering shorter product development cycles, lower maintenance costs and fast technology insertion, our systems ensure a high level of military force readiness, now and in the future for current and transformational platforms.

Naval Electronics and Intelligence Systems

DRS is recognized as the leading producer of mission critical display workstations and servers for the U.S. Navy. Designed to support many different surface, submarine and air platforms in command and control applications, the Q-70 family of display and processing systems is a cornerstone in the Navy's Aegis, submarine and modernization programs.

As the tempo and complexity of Naval engagement increases, the need for sharing real-time situational awareness data among decision makers becomes an even greater requirement for mission success. To address this requirement, DRS is providing Group Decision Consoles and is the lead design agent and builder of the Horizontal Large Screen Display and NSSL Navigation Decision Workstation for submarines and Computer Aided Dead Reckoning Tracer for surface combatants and carriers. Under the Q-70 Technology Insertion program, DRS is developing a new generation of Naval display systems that feature improved interoperability with legacy systems, reduced size and weight, and state-of-the-art human/system interfaces.

As an established leader in providing hardware and middleware for defense computing environments, DRS is focused on developing next generation network-centric computing infrastructures and specialized interfaces for future Naval platforms, such as the DD(X) destroyer, CVN-21 aircraft carrier, Littoral Combat System (LCS) and CG(X) cruiser.

DRS provides the Navy with advanced systems that leverage next generation Naval open architecture, allowing for interoperability and flexibility across the total ship and theater computer environments. These technologically advanced systems, such as our multi-function display workstations, integrate sensor, internal voice communications and other situational awareness data by incorporating the latest advanced processing, software development and multi-level network security technologies available. In addition to being lighter and requiring less space, these advanced



For the U.S. Navy's AN/UYQ-70 Advanced Display Systems program, DRS produces a family of tactical display consoles for combat, command and control, and mission-essential operations on ships, submarines and aircraft.

systems allow the Navy to realize significantly reduced ship manning through newly developed human/system interfaces.

Experience gained through the Aegis Tactical Display Upgrade program makes DRS a value-added supplier in middleware for next generation Naval platforms. These software tools simplify application development and maintenance for system developers, while providing a means to translate hardware specifics to standard application interfaces, aiding hardware configuration control and enhancing our market position in the display and sensor processing systems business.

Complementing our progress in defense computing for the transformational Navy, the Electronics Systems Group recently initiated a major technology refresh of the AN/SPS-67 Surface Surveillance Radar System that will produce a more capable and versatile system suitable for current and future combatants, amphibious platforms and fast patrol boats. DRS also developed the Secure Voice System (SVS) for advanced internal ship communications. Installed on U.S. aircraft carriers and included in the latest DDG-51 Combat System baseline, our next generation SVS is being developed



to become the backbone of a fully integrated voice and data transfer system to support the entire range of internal ship communication transformational requirements.

DRS's Electronic Systems Group is continuing to incorporate the dynamic, fast-paced technology improvements evolving in the commercial computer and communications industries to provide new approaches for seamless military operations. The increased use of higher bandwidth networks, wireless communications devices, satellite communications and military intranets is providing growth opportunities for implementing a new generation of products to address future requirements, including system level solutions, openly designed system configurations, internal

networks, high-speed data processing, single-board flat panel computers, secure data dissemination, and remote monitoring and diagnostics. These products provide decision makers with a dramatically improved capability to act in a fully informed and decisive manner.

With the acquisition of Paravant during fiscal 2003, we expanded our presence in high-end, cost-effective, advanced signal processors, high-performance spectrum analyzers, digital switching matrices and recording systems for signal intelligence (SIGINT) gathering applications, deployed on airborne military platforms such as the U.S. Air Force RC-135V/W Rivet Joint. The acquisition also contributed avionics support programs for U.S. and international helicopter and airlift aircraft modernization.

Tactical Systems

DRS is a world leader in high-performance tactical computer systems and integrated peripheral products designed to operate in harsh military environments to support the digitization of the 21st century battle space. Our mission-critical rugged computers, servers, flat panel displays and other peripheral products support a variety of U.S. Army and Marine Corps ground force modernization and Command, Control, Communications, Computers and Intelligence (C⁴I) platform transformation applications for land, sea and air operations. These systems are crucial for rapidly fielding advanced computer technology to support coordinated military operational strategies. Successfully deployed for mobile forces, our portable, battle-ready and highly reliable Commercial Off-The-Shelf (COTS) workstations, laptops and handheld computers are proven to operate under extremely harsh conditions. With an unparalleled level of performance, functionality and ruggedization, these systems directly support the goals of U.S. and allied international armed forces under current initiatives to dominate the expanded battle space. Through several primary programs, this line of business provides system solutions grounded in standard rugged computer products that are customized to meet unique mission, platform and environmental requirements.



DRS supports the U.S. Army's Common Hardware/Software II (CH/S-2) program with the Explorer MP™ Rugged Portable Multi-Platform Workstations, which are full-function, integrated, portable UltraSPARC III™ computers. These systems provide users with the capability to run Combat Information Systems (CIS), Geographic Information Systems (GIS), fire control and digital mapping applications, as well as other sophisticated programs. Utilizing the latest Sun SPARC™ and Intel® Pentium® processors together with a range of advanced multimedia and graphics systems, the Explorer MP™ can support new versions of the ATX form factor processors, as they become available, as well as a wide range of environmental and Electro-Magnetic Interference (EMI) requirements.

With the acquisition of Paravant during fiscal 2003, we added key programs that expanded our participation in military transformation initiatives supporting battlefield digitization, and expanded our engineering capability in software design and integration for customizing standard products to the specific needs of end users. For the U.S. Army's Force XXI Battle Command, Brigade and Below (FBCB2) program, DRS is providing Appliqué tactical computers, which feature innovative design and proven performance. Focused on developing a digital battle command information system designed to provide commanders, leaders and soldiers, from brigade to individual soldier and across all



the battlefield functional areas, with improved information for command and control and enhanced situational awareness, DRS's role on this program is the direct result of our commitment to provide best value systems and services. This dedication affords us opportunities to participate in other next-generation, high-visibility, battlefield command information system programs.

Incorporating the latest developments in digital information processing and networking, the FBCB2 system provides improved combat support, real-time command and control capabilities, enhanced interoperability and situational awareness throughout the force structure at the soldier, weapons and platform levels, assuring that U.S. armed forces keep pace with advanced technology developments. As a vehicle computer system, its interoperability with external command and control and sensor systems provides a seamless flow of battle command information. For situational awareness, the system collectively displays the geographical location of all weapons, platforms, soldiers, command posts and other facilities and is used in conjunction with the Army's Tactical Internet (TI). Interfacing with the Army Tactical Command and Control System (ATCCS), the TI collects information from both the operation center and the individual units, and disseminates it through FBCB2 computers.

DRS also provides mobile satellite worldwide messaging and tracking systems for the U.S. Army's Movement Tracking System (MTS), one of the most advanced battlefield digitization programs

for support vehicles. A low-cost solution for secure, real-time tracking of vehicles and communications, MTS identifies position, track and progress, and communicates with the operators of tactical wheeled vehicles. Enhanced by a global positioning system (GPS), vehicle mapping and two-way satellite messaging, our system locates and tracks an asset's position using personal computer-based software.

For the United Kingdom's BOWMAN program, DRS is providing computers to support a secure digital voice and data communication system based on Internet protocol. With an objective to deliver a land-based command and control system that will provide the infrastructure to support all digitization applications over the next 30 years, BOWMAN will equip approximately 18,000 army vehicles and 60,000 service personnel as the largest defense communications program in the U.K. in over 50 years. For this program, DRS is producing lightweight Scorpion™ notebook computers, built to survive the most rugged conditions encountered. Intel® Pentium®-based, fully sealed with a Windows® 98/2000/NT/XP operating system, wide temperature range, strong construction and warranted performance, the Scorpion™ delivers the best available rugged computer technology to ground and airborne war fighters. Employing an entirely COTS internal architecture, an exceptional daylight readable screen, removable hard drive and hot swappable batteries, the Scorpion™ provides reliable operation in the most extreme environments.

Through the Paravant acquisition, we also added U.S. and allied international Air Force programs to DRS's product mix. Our Altitude Hold and Hover Stabilization (AHHS) system, a complex stabilization system using air data sensors, radar



altimeter and an inertial navigation and GPS, is installed on more than 100 CH-53 helicopters. Combining our C4I experience with communications equipment integration in airborne tactical receivers for such platforms as the A-10 Warthog and C-130 Hercules, this system expands our role to combat aircraft system integration for the digital battle space.

Power Systems

With the acquisitions of Eaton's Navy Controls Division, Kaman's Electromagnetics Development Center and Power Technology Incorporated during fiscal 2003, DRS Technologies has become the U.S. Navy's only domestic supplier capable of designing, developing and producing a completely integrated electric or mechanical drive propulsion plant, powered by steam or gas turbine engines or propulsion plant components. We also are pursuing select industrial applications, leveraging highly synergistic product requirements for commercial use. The broad range of our power systems product lines encompasses Navy nuclear products, ship control, propulsion and electric drive systems, technology development, steam and gas turbines, pump technology, industrial systems and fuel cells. Our Group's combined capabilities in power equipment, combat and control systems, and ship networks have uniquely positioned DRS as a total ship computing systems provider for the Navy. Our leadership position in integrated Hull, Mechanical and Electrical (HM&E) equipment strongly complements our presence in Naval advanced command and control systems, tactical computer displays and other ship systems. With power equipment installed on every U.S. Navy combatant ship since World War II, including nuclear-powered and conventionally-powered ships, and a major installed base of electronic equipment in today's fleet, DRS is well positioned to benefit from the Navy's backfit, modernization and transformational initiatives. We are poised to play an increasingly important role in the Navy's aggressive new shipbuilding programs.



DRS already has captured key positions on next generation programs, including the Virginia class submarine and the CVN-21 future aircraft carrier. Our electric drive system is the baseline for the propulsion of the Navy's next new ship design, the DD(X) destroyer. Teamed with Northrop Grumman Ship Systems and Newport News Shipbuilding on the DD(X) program, DRS is the contracted supplier for key elements of the electric drive system for the engineering development models, including propulsion motors, drive controls and power electronics, as well as the packaged gas turbine generators. Our unique role enhances our ability to expand onto other electric drive platforms supporting Navy growth initiatives. Strategically important to our goal of increasing DRS equipment content on board ships in the DD(X) program, our power systems business is important to our long-term goals for growth. Future platforms, such as the LCS and CG(X) cruiser, will provide further opportunities for expansion. The Navy's transformational focus on ship electric drive and propulsion equipment, power electronics and networks supports our positive outlook for this business.

For Navy initiatives requiring a wide range of advanced propulsion plant technologies, DRS provides the most diverse variety of propulsion and power electronics equipment deployed or under development. We apply our unique expertise in high-performance, lightweight electric motors, generators and drive electronics for defense, industrial and transportation applications, having pioneered the application of

permanent magnet motors and solid-state power electronics in large machines.

DRS's Secondary Propulsion Unit Drive (SPUD) blends the unique technologies of our already deployed advanced power electronics equipment with our revolutionary, high power density electric drive technologies we developed for the Navy's Large Scale Vehicle 2 – a scale model of the Virginia class submarine built with General Dynamics Electric Boat for hydro-acoustic studies. Offering extremely high power density, fidelity and thermal efficiency, this propulsion system is viewed as having a potentially large future market, as the Navy moves toward creating more stealthy, cost-effective ships.

The largest supplier of nuclear instrumentation and control systems, DRS developed the Millennium Motor Control product line, which incorporates microprocessor and Local Area Network (LAN) technologies. Initially targeted for the LPD-17 amphibious ship, Virginia class submarine and CVN-76 aircraft carrier classes, this line also will be deployed on the next group of Arleigh Burke class Guided Missile Destroyers, placing it on every new ship under construction for the U.S. Navy.

Our line of highly reliable drill head motors was developed for systems supporting industrial oil and gas exploration. We have a strong reputation as an innovator in electromagnetics. For vehicle propulsion, we are developing novel wheel motors to support the U.S. Army's Future Combat System and hybrid truck programs, which leverage our successful transit system motors, drives and electric propulsion generators.



DRS has power equipment on every U.S. Navy combatant, including nuclear- and conventionally-powered ships, and is well positioned to benefit from the Navy's backfit, modernization and transformational initiatives.



Electro-Optical Systems Group

- 1** DRS produces advanced focal plane arrays for remote sensing and countermeasures. **2** DRS produces the LRAS3 sighting system for the Long Range Scout Vehicle and is the sole source supplier of the Mast Mounted Sight for the Kiowa helicopter. **3** DRS provides the Command Launch Unit for the Javelin Missile System and FLIRs for the Apache and Comanche helicopters. **4** DRS is designing the Cost Effective Targeting System for UGVs and UAVs to autonomously search for threats. **5** DRS provides second generation infrared sighting systems supporting Abrams and Bradley ground vehicles for the U.S. Army's Horizontal Technology Integration program. **6** For carriers, DRS provides the VISUAL aircraft tracking and landing system used to safely land aircraft during adverse conditions.



7 For ships, DRS produces the Thermal Imaging Sensor System to detect surface and airborne threats. **8** DRS provides the AN/TAS-4(X) Upgrade for the TOW Night Sight weapons launcher. **9** DRS produces a Driver Vision Enhancer for night operations or periods of degraded visual conditions caused by smoke, fog, dust or other battlefield obscurants. **10** DRS provides the Nightstar®, a lightweight binocular system for infantries, special forces and night operations involving forward observers and reconnaissance patrols. **11** DRS provides missile seeker sensors with mid- or long-wave spectral bands. **12** DRS's Neptune™ UAV can launch from a small boat and land in water. **13** DRS produces the Land Warrior Thermal Weapon Sight and other night vision head gear using lightweight uncooled infrared technology.



Fred L. Marion
Group President

DRS Technologies is a leader in electro-optical system technologies supporting the transformational efforts and vision of the U.S. Armed Forces, as they strive to meet the strategic responsiveness and dominance goals of Joint Vision 2020. A leading producer of infrared sighting and targeting systems for critical front-line ground vehicle, surface ship, airborne, weapon and soldier system platforms, DRS excels in the development, production and support of high-performance thermal imaging systems and advanced sensors for a variety of battle space applications. Our technology also has significant long-range strategic implications for target recognition and discrimination, command and control effectiveness, and high-value asset protection.

DRS is a key supplier to the U.S. government for advanced night vision technology incorporated in sighting systems for ground, sea and air targeting and missile guidance systems, as well as airborne, space-based and remote early warning target detection devices. Our focal plane array sensors provide clear visual imagery from long ranges, regardless of light level, smoke, dust, fog and other battlefield obscurants that can cripple the mobility, reactions and missions of heavy materiel. Our systems apply critical common night vision technology across several land, sea and air platforms supporting the strategic armed forces network and hold a crucial role in the digital battle space of the 21st century. This technology promotes real-time situational awareness, forward engagement and survivability, as a result of its capability for threat detection at greater stand-off ranges.

DRS's Electro-Optical Systems Group applies technologies over a full range of systems supporting the Army's vision of fielding an Objective Force – one that is strategically responsive, deployable, agile, versatile, potent, survivable and sustainable across a spectrum of military operations from major theater warfare through counter terrorism and homeland security. Operating as part of a joint or

inter-agency team, the Objective Force will be capable of conducting rapid precision offensive, defensive, stabilizing and multi-dimensional support operations, transitioning between missions without a loss of momentum.

The transformation efforts of the U.S. Army, our primary customer, are focused on fielding this Objective Force, which incorporates the M1A2 Abrams Main Battle Tanks and M2A3 Bradley Fighting Vehicles of the Army's Counter-Attack Corps, the Strykers of the Brigade Combat Team (BCT), the Future Combat System (FCS) and the Objective Force Warrior (OFW). DRS's Electro-Optical Systems Group is playing a key role in developing and producing the "eyes" of the Objective Force. Our systems allow troops to see first, understand first, act first and maneuver decisively for tactical success. Faced with this key initiative seeking to assimilate the best aspects of heavy, light and medium capabilities, DRS is involved in a number of programs that support transformational efforts and is helping to make the military's vision a reality.

For the Counter-Attack Corps of the Objective Force, DRS provides the M1A2 Abrams Main Battle Tank System Enhancement Program (SEP), the M2A3 Bradley Fighting Vehicle, the long range mobile surveillance Scout and the Javelin Missile System with the ability to detect, identify and engage tactical targets, while dramatically increasing target acquisition performance, operational stand-off ranges and troop survivability.

Supporting the Brigade Combat Team, DRS is supplying electro-optical subsystems for the Reconnaissance, Fire Support, Mobile Gun and Infantry Variants of the Stryker Force. The Long Range Advanced Scout Surveillance Systems (LRAS3) on the Reconnaissance and Fire Support Variants provide long-range Reconnaissance, Surveillance and Target Acquisition (RSTA) capability. Our next generation Forward Looking Infrared (FLIR) systems supply the Mobile Gun Variants with situational awareness and target acquisition capability supporting



DRS's advanced, high-resolution, infrared sighting systems on the M2A3 Bradley, other U.S. Army ground platforms and weapon systems are crucial for providing troops with the ability to be the first to see the opposition at extended ranges, understand the situation, accurately target and engage.



Infrared sensors and electro-optical components and assemblies are incorporated in our day/night vision sighting systems for ground, weapon, sea, air and space-based applications.



this direct-fire system. In addition, many variants of the basic Stryker carry a remote weapons station built around DRS's uncooled infrared technology. This technology supports the lighter, more mobile combat-capable brigade force, which is intended to be deployed anywhere in the world within 96 hours.

For airborne applications, DRS provides the Objective Force next-generation FLIR for both the Apache and Comanche helicopters. The Comanche has been dubbed by the Army's leadership as the "quarterback" of this next generation force. DRS also is the sole producer of the Mast Mounted Sight installed on the OH-58D Kiowa Warrior helicopter, the primary reconnaissance/attack helicopter platform for the U.S. Army with a long history of successful deployment in a variety of scout and attack missions around the world. Installed above the rotors, DRS's Mast Mounted Sight, an integrated, multi-sensor electro-optical sighting system using visible and advanced infrared technology, gathers imagery and target acquisition data during the day or night under harsh battlefield conditions. Specifically designed for extended stand-off range operations, the Mast Mounted Sight is considered critical in forward battle areas and reconnaissance missions.

The Future Combat System, a top priority Army program supporting the Objective Force transformation, is a networked "system of systems" intended to include robotic reconnaissance vehicles and sensors, mobile command, control and communications platforms, networked fires from ground and air platforms, and advanced three-dimensional targeting systems operating on land and in the air. DRS is supporting

several Future Combat System-related programs that are demonstrating technologies for improved combat vehicle and soldier system sensing. As the prime contractor for the Cost-Effective Targeting System (CETS), the key element of an Advanced Technology Demonstration system called Networked Sensors for the Objective Force, DRS directly supports the Army's Future Combat System initiative. With CETS, target search, detection and prioritization become automated in a highly reliable targeting system that delivers nearly the high performance of our second-generation systems at half the cost. DRS's Electro-Optical Systems Group is leading the effort to integrate this modular, multi-sensor suite, which incorporates Aided Target Recognition (AiTR), for use on a variety of manned and unmanned air and ground platforms.

The Objective Force Warrior is a pillar in the Objective Force strategy, complementing the Future Combat System program, and is the Army's flagship science and technology initiative. Its purpose is to develop and demonstrate revolutionary capabilities for Objective Force soldier systems. An integrated "system of systems" approach is being employed to support the Army transformation to a soldier-centric force. As a major subcontractor to General Dynamics on this program, DRS is the sensor integrator for the soldier weapon, helmet and related unmanned air and ground vehicles. Implementing uncooled infrared technology, this integrated suite of sensors provides the soldier with advanced situational awareness and



targeting information, allowing unprecedented lethality for the opposition and survivability for our own troops on any battlefield.

Our uncooled infrared technology supports a number of strategically important sensor programs in which DRS is participating that are considered key to the military's vision of a lighter, mobile, ground force for the battlefield. DRS also employs this technology in sights for rifles and automatic weapons and other low-cost soldier systems, where lighter, smaller and less expensive infrared capability is required. This technology also has applications for homeland defense and border patrol.

DRS's competitive market position for electro-optical system programs associated with this growing uncooled/soldier systems business was strengthened with the acquisition of Nytech Integrated Infrared Systems during fiscal 2003. Nytech enhances our ability to participate in the Objective Force Warrior and other programs requiring leading edge, lightweight, low-cost, thermal imaging systems. The Nytech acquisition added uncooled infrared products, such as FLIR cameras and thermal sensor modules that have applications for unmanned ground vehicles (UGVs), unmanned aerial vehicles (UAVs), missile guidance and sensor fusion. Through this acquisition, DRS expanded onto such programs as the Thermal Weapon Sight (TWS) II, Driver Vision Enhancement (DVE) II, Small Arms Fire Control System (SAFCS), Thermal Sight for the XM-29 Integrated Air Burst Weapon, which was formerly the Objective Individual Combat Weapon, Low Power Uncooled Infrared (LPUiR) and the Pointer UAV, among others.



Our electro-optical technology makes us uniquely qualified to participate on a number of innovative, revolutionary, leading edge programs. During fiscal 2003, we were selected to design and develop state-of-the-art active and passive infrared sensing systems for the Vertical Integrated Sensor Arrays (VISA) program of the Defense Advanced Research Projects Agency (DARPA), Microsystems Technology Office, which supports future advanced military and space surveillance applications. This program is focusing on massively parallel signal processing in focal plane array (FPA) technology necessary to address future strategic and tactical system needs of multi-function active and passive thermal imaging and laser jamming avoidance not addressed with current FPA technology. The

technology DRS provides will advance the strategic responsiveness and forward deployment capabilities of U.S. military forces. Critical to national defense with significant strategic implications for the 21st century, the techniques we are developing are based on our high-density, vertically integrated photodiode detector technology.

Supporting our thrust into airborne threat warning and countermeasures, the Multifunction Electro-Optics for Defense of U.S. Aircraft (MEDUSA) program addresses the emerging threat of non-RF (Radio Frequency) air defenses. With the proliferation of a wide variety of missile types, including hand-held infrared seeker, command-guided and laser aided, the MEDUSA program uses active and passive optical systems to search, track, classify and defeat the threat, breaking the enemy air defense chain at multiple points. DRS's multicolor, avalanche photodiode arrays technology is key for this program. It is anticipated that this and other DRS-developed multicolor infrared FPA technologies will continue to be utilized for theater missile defense and other future military applications involving threat warning.

DRS's technologies have applications for homeland defense and force protection initiatives, as well. Our fiscal 2003 acquisition of the U.S.-based Unmanned Aerial Vehicle business of Meggitt Defense Systems – Texas provides the Electro-Optical Systems Group with the opportunity to build close-range, low-weight, low-noise, medium-duration unmanned aerial vehicles (UAVs) for special military operations. These UAVs specifically are designed for tactical short-range surveillance, radio relay, and command, control, communications, computers, intelligence, surveillance and reconnaissance (C4ISR). The incorporation of DRS's core technologies in computer display systems, electro-optical and infrared sensors and targeting systems, high-speed digital cameras, data recording and

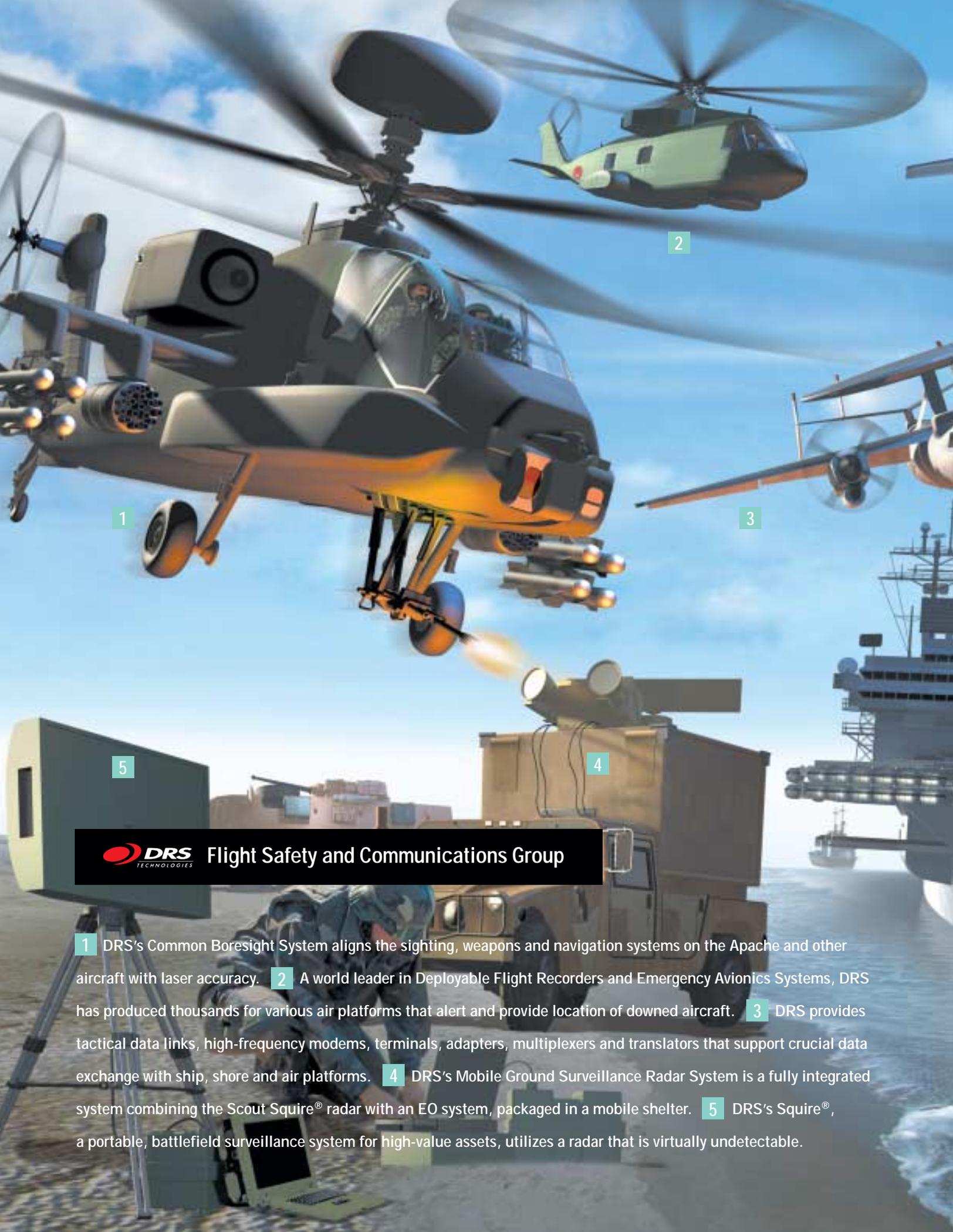
communications systems is expected to contribute to the growth of our UAV business, as will broad appeal for the increased use of UAVs. Military applications for these platforms include infrared camera surveillance, chemical/biological sensing, threat identification and targeting, weapons launching and payload drops. Civil applications include aerial surveying, fire fighting and intelligent transportation system monitoring.

Also supporting homeland defense and force protection markets, DRS developed the Common Aperture Advanced Targeting System (CAATS) for maritime and airborne applications. Useful in navigation, threat detection and identification, target tracking and engagement, CAATS provides high-quality surveillance video and three-dimensional targeting data for a weapon control system. This system is integrated easily into U.S. Navy combat systems, providing engagement of such threats as sea skimming missiles and small boats.





DRS produces FLIR detectors, assemblies and cryogenic coolers for the Command Launch Unit of the Javelin Anti-Tank Weapon System, the world's premier man-portable, fire-and-forget weapon system used by the U.S. Army and Marine Corps combat units.



Flight Safety and Communications Group

1 DRS's Common Boresight System aligns the sighting, weapons and navigation systems on the Apache and other aircraft with laser accuracy. **2** A world leader in Deployable Flight Recorders and Emergency Avionics Systems, DRS has produced thousands for various air platforms that alert and provide location of downed aircraft. **3** DRS provides tactical data links, high-frequency modems, terminals, adapters, multiplexers and translators that support crucial data exchange with ship, shore and air platforms. **4** DRS's Mobile Ground Surveillance Radar System is a fully integrated system combining the Scout Squire® radar with an EO system, packaged in a mobile shelter. **5** DRS's Squire®, a portable, battlefield surveillance system for high-value assets, utilizes a radar that is virtually undetectable.



6

7

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6 DRS provides mission and cockpit video data recorders for a range of aircraft deployed throughout the world.
7 DRS's Secure Voice System for advanced ship communications supports a fully integrated voice and data transfer system for a range of transformational requirements. 8 DRS's Shipboard Integrated Communications System provides multi-channel audio processing, enhancing intercommunications by radio and internal nets. 9 DRS's Airborne Separation Video System is the first multi-camera, fully integrated, digital imaging system to support the testing of weapons separation in flight.

9



David W. Stapley
Group President

DRS Technologies is an international leader in avionics and aircraft weapons support systems, Naval and airborne integrated communication, data link and encryption systems, electronic surveillance systems and data capture technologies that support the transformational efforts of the U.S. Navy, Army and Air Force. Our systems also support the modernization goals of allied militaries to meet coordinated strategic responsiveness and superiority initiatives for integrated battle space operations. As a leading producer of these technologies for surface ships, carriers, ground vehicles, air platforms and soldier systems, we excel in the development, production and support of ship communications systems, secure data link transmission systems, deployable flight incident and mission recorders, aircraft weapons alignment systems, high-speed digital imaging systems, and surveillance radar and infrared systems for a variety of sea, air and land applications.

Systems built by the Flight Safety and Communications Group operate throughout the world on fixed- and rotary-wing aircraft, on mobile ground units for surveillance applications, in remotely operated and portable border protection systems, and at sea on board front-line U.S. Navy and international surface ships and carriers.

DRS's Flight Safety and Communications Group supports system solutions involving several technology areas with a diverse number of applications. Many of our systems support the military's information superiority, forward deployment and littoral surveillance initiatives. As a leader in communications and data link products, we provide critical information technologies that connect battle group elements in support of the network-centric plan and strategic vision of Sea Power 21 for fully coordinated theater warfare and enhanced tactical command and control. In a joint development effort to improve ship self-defense capability, we provide automatic infrared detection and target tracking systems for anti-ship missiles and aircraft, which complement existing radar surveillance systems, positioning DRS as a key supplier for allied international fleet operations. For international army border defense, we provide sophisticated, virtually undetectable radar systems incorporating the best

available surveillance technology in lightweight configurations. As a world leader in deployable flight incident recorder systems, DRS produces integrated data and voice recording technology in a unit that ejects from the exterior of the aircraft and is more easily recoverable than the traditional "black box" device. A market leader in data and imaging systems, we provide high-speed digital camera systems that capture in-flight test results of weapons release for U.S. Navy and Air Force aircraft, ballistics data for test ranges, engine combustion events for industrial studies and data for automated manufacturing process improvements. And, for aircraft weapons, navigation and sighting gear calibration, DRS provides common boresight equipment used on U.S. Army attack helicopters and gunships.

Communications and Surveillance Systems

The communications, tactical data link and sensor processing systems of DRS's Flight Safety and Communications Group provide solutions for critical simultaneous, complex, joint battle group operations across the strategic and tactical combat levels of the non-linear battle space. Our technology has an important role in communications initiatives that are considered vital to military platform interoperability. As the world leader in the supply of Link 11 data communication, secure modem and telephonic product solutions, DRS is supplying next-generation equipment for secure voice and data communications, as well as for advanced digital communications networks.

DRS's communications and data link systems are key in enabling ships in a battle group to share real-time secure intelligence data to enhance war fighting assets in a joint or coalition task force. These products support the crucial exchange of tactical command and control data with ship, shore and air platforms. They also are applicable to the Joint Fires Network capability – a network-centric warfare system that provides real-time intelligence correlation, sensor control, target generation, mission



DRS provides aircraft calibration equipment for the sighting, navigation and weapons systems on the U.S. Air Force F-16 Fighting Falcon, and Airborne Separation Video Systems that capture weapons release during test flights.



Our next generation internal ship communication systems are becoming the backbone of a fully integrated voice and data transfer system to support the entire range of secure and non-secure communication transformational requirements.



planning and battle damage assessment capabilities, while also allowing real-time engagement of time-critical targets. As this network initiative matures, its importance will be evidenced by more precisely targeted and delivered ordnance than ever seen before.

We have actively built upon an existing international customer base for integrated ship communication systems, with installations throughout Canadian and other fleets. We also have successfully penetrated the U.S. Naval market for secure voice communication systems on Aegis class surface ships and aircraft carriers, and are developing a new, advanced encryption product line. Increased requirements for high-frequency, wireless and satellite communications are providing growth opportunities and the impetus for implementing a new generation of products, including system level solutions.

For the U.S. Navy's AN/UYQ-70 Common Data Link Management System, the Flight Safety and Communications Group is producing Common Shipboard Data Terminal Sets, which will be able to perform multi-frequency Link 11 operations and incorporate the improved Link 22 signal processor controller function. DRS's Tactical Dissemination Modules for both surface ships and mobile ground platforms serve as tactical communication links from ships to fighter aircraft. This program highlights our ability to rapidly deliver integrated interior and exterior communications suites, and

positions DRS as a critical supplier of tactical communication links and video products to platforms capable of weapons delivery.

Our innovative Secure Voice System supports advanced internal ship communications on U.S. aircraft carriers and also is included in the latest DDG-51 destroyer Combat System baseline. This next generation system is becoming the backbone of a fully integrated voice and data transfer system to support the entire range of internal ship communication transformational requirements. By applying unique audio algorithms, it spatially separates four audio channels and enhances acoustics for the user in fast-paced joint combat and readiness operations, and command and decision functions. Supplementing existing communications functions, DRS expanded system capabilities to include transmission of data, as well as voice.

During this fiscal year, DRS secured new contracts to provide tactical data link equipment for operation on board Australia's new Wedgetail aircraft. The Wedgetail aircraft and systems are planned for transformation to Airborne Early Warning and Control (AEW&C) capabilities for the Royal Australian Air Force. Our communications products will provide real-time information exchange between commanders and ground, sea and air forces to support integrated battle space operations, while our rugged computer systems will act as the main host computer processor for the aircraft's electronic support measures.

Systems representing other shipboard technologies include our high-end signal processors for infrared search and track, and other naval sensor applications. These systems support anti-missile and ship self defense through automatic detection and target tracking of anti-ship missiles and aircraft. Integral to a ship's local area defense, they complement existing radar surveillance systems and have potential to enhance a naval Tactical Ballistic Missile Defense capability. Along with our ship- and ground-based coastal and border surveillance systems employing radar and night vision technology, these systems directly support the military's information superiority, forward deployment, force protection, littoral surveillance and homeland defense initiatives.

Supporting international army border defense programs, DRS provides Mobile Ground Surveillance Radar Systems (MGSRS) utilizing the Squire® Surveillance Radar – a sophisticated, solid-state, virtually undetectable system designed for the identification and classification of moving ground targets. The MGSRS includes an electro-optical package, and a control and display station integrated into high-mobility wheeled vehicles. Contributing to national security objectives, these systems employ the most reliable, effective surveillance, display and electro-optical technologies available.



They also can be deployed to safeguard valuable assets, such as oil fields and power stations, from terrorist or criminal acts, and have been utilized successfully for battlefield surveillance and border control, as well as drug interdiction operations.

For ground-based Canadian forces, DRS also provides upgrade kits for the AN/TAS-502 Night Observation Device, Long Range (NODLR). The man-portable or vehicle-mounted NODLR detects and identifies targets at extended ranges, reducing observer vulnerability. Comprised of second generation Focal Plane Arrays (FPAs) and electronic components, the kits double the range of current systems and dramatically improve operation with increased reliability and noise reduction. Immune to known countermeasures and not blinded by flares, searchlights or lasers, the NODLR penetrates most natural and man-made obscurants to ensure operational effectiveness around the clock.

Data and Imaging Systems

DRS is the world leader in innovative deployable avionics systems that combine a cockpit voice recorder, flight data recorder and an emergency locator beacon in a single, crash-hardened unit mounted on the exterior of the aircraft. Since the unit jettisons from the airframe within milliseconds of an impact, it avoids destructive forces of a crash on land and floats indefinitely in water. Once deployed, the beacon emits a signal for search and rescue teams. Delivered to thousands of U.S. and international military aircraft and



helicopters, these systems have a significant impact on search and rescue missions, dramatically reducing time and costs associated with the recovery of black box data. Complementing this line, we produce aircraft monitoring and ground replay systems.

Our mission data and cockpit video recorders fly on a wide range of U.S. and international aircraft. Recently developed products incorporate the latest Commercial Off-The-Shelf (COTS) technologies for capturing multi-mission sensor data and are complemented by our ground-based replay and analysis systems. DRS recorders provide improved performance, lower operating costs and reduced weight. We have delivered several thousand systems to the U.S. Navy, U.S. Air Force and U.S. Army, as well as international military forces, for air, sea and land applications.

Our high-speed digital camera systems are becoming recognized as the world's standard for digital imaging in the evaluation of critical airborne weapons release processes. DRS's Airborne Separation Video System (ASVS) is the only high-speed digital imaging system designed and qualified to replace film cameras for the capture of weapons' separation from aircraft during flight tests. The unique design of our Multi-camera System Controller allows the system to simultaneously control up to 32 cameras in flight. Already used on the U.S. Navy's F/A-18 Hornet aircraft, we expanded applications to the U.S. Air Force F-16 Fighting Falcon and other international air force platforms. We also produce ultra high-speed cameras for other military, scientific and industrial applications. Our comprehensive line of ultra high-speed cameras for military ballistics and civil research have advanced applications in universities, defense facilities and national particle physics programs.

Additional avionics product lines include our Common Multi-Platform Boresight System – a proprietary, infrared laser, tri-axial measurement system that provides precise calibration of an aircraft's weapons, sighting and navigation systems in a portable, cost-effective and time saving package that is essential ground support equipment. In fiscal 2003, we expanded the application of this system to include the U.S. Air Force's F-16 Fighting Falcon and F-15 Eagle, in addition to the Army's Apache Longbow and Marine Corps' Cobra helicopters, and Air Force's Spectre gunships.





DRS is the world leader in deployable flight incident recorders. Mounted to the outside of an aircraft, they eject prior to impact and emit a locator beacon, expediting search and rescue.



Technology for

Protecting Freedom

Defending Values

Making History

Safeguarding the Future

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Selected Financial Data

DRS Technologies, Inc. and Subsidiaries

(in thousands, except per-share data and ratios)	Year Ended March 31,				
	2003	2002	2001	2000	1999
Summary of Earnings					
Revenues	\$675,762	\$517,200	\$427,606	\$391,467	\$265,849
Operating income	\$ 67,684	\$ 49,769	\$ 37,531	\$ 26,178	\$ 15,301
Earnings from continuing operations before income taxes and extraordinary item	\$ 55,872	\$ 38,361	\$ 24,954	\$ 12,832	\$ 5,780
Earnings from continuing operations before extraordinary item	\$ 30,171	\$ 20,331	\$ 11,978	\$ 7,661	\$ 3,865
Net earnings	\$ 30,171	\$ 20,331	\$ 11,978	\$ 4,310	\$ 680
Per-Share Data from Continuing Operations (1), (2)					
Basic earnings per share	\$ 1.64	\$ 1.52	\$ 1.14	\$ 0.83	\$ 0.58
Diluted earnings per share	\$ 1.58	\$ 1.41	\$ 1.01	\$ 0.76	\$ 0.57
Summary of Financial Position					
Working capital	\$100,024	\$165,237	\$ 43,686	\$ 21,384	\$ 13,491
Net property, plant and equipment	\$ 87,610	\$ 50,481	\$ 37,639	\$ 29,006	\$ 32,124
Total assets	\$972,121	\$601,091	\$334,940	\$320,098	\$329,639
Long-term debt, excluding current installments	\$216,837	\$138,060	\$ 75,076	\$ 97,695	\$102,091
Total stockholders' equity	\$438,180	\$257,235	\$111,947	\$ 78,184	\$ 73,442
Financial Ratios and Supplemental Information (1)					
EBIT (3)	\$ 65,282	\$ 48,171	\$ 36,213	\$ 25,232	\$ 14,787
EBITDA (3)	\$ 81,942	\$ 61,960	\$ 52,338	\$ 42,302	\$ 26,388
Free cash flow (4)	\$ 30,482	\$ 14,266	\$ 18,085	\$ 1,807	\$ 9,004
Cash flows from operating activities of continuing operations	\$ 52,008	\$ 27,849	\$ 34,270	\$ 8,017	\$ 15,558
Capital expenditures	\$ 21,526	\$ 13,583	\$ 16,185	\$ 6,210	\$ 6,554
Depreciation and amortization	\$ 16,660	\$ 13,789	\$ 16,125	\$ 17,070	\$ 11,601
Internal research and development	\$ 14,355	\$ 9,535	\$ 8,027	\$ 9,867	\$ 5,104
Net debt (5)	\$129,137	\$ 21,939	\$ 80,800	\$117,397	\$107,073
Interest and related expenses	\$ 10,589	\$ 10,954	\$ 11,461	\$ 12,600	\$ 9,357
Interest coverage ratio (6)	7.7x	5.7x	4.6x	3.4x	2.8x
Long-term debt to total capitalization	33.9%	35.1%	42.2%	51.9%	56.6%
Long-term debt to EBITDA	2.7x	2.3x	1.6x	2.4x	4.1x
Net debt to EBITDA	1.6x	0.4 x	1.5x	2.8x	4.1x

(1) Per-share data and financial ratios from continuing operations are presented and calculated before extraordinary item recorded in fiscal 1999 in connection with the write-off of deferred financing fees relating to a previous credit facility.

(2) No cash dividends have been distributed in any of the years presented.

(3) Earnings from continuing operations before extraordinary item, net interest and related expenses (primarily amortization of debt issuance costs), income taxes (EBIT) and depreciation and amortization (EBITDA). See Management's Discussion and Analysis of Financial Condition and Results of Operations, Use of Non-GAAP Financial Measures.

(4) Cash flows from operating activities of continuing operations less capital expenditures. See Management's Discussion and Analysis of Financial Condition and Results of Operations, Use of Non-GAAP Financial Measures.

(5) Total debt net of cash and cash equivalents. See Management's Discussion and Analysis of Financial Condition and Results of Operations, Use of Non-GAAP Financial Measures.

(6) Ratio of EBITDA to interest and related expenses (primarily amortization of debt issuance costs).

The following is management's discussion and analysis of the consolidated financial condition and results of operations of DRS Technologies, Inc. and Subsidiaries (hereinafter, we, us, our, the Company or DRS) as of March 31, 2003 and 2002, and for each of the fiscal years in the three-year period ended March 31, 2003. This discussion should be read in conjunction with the audited consolidated financial statements and related notes.

Forward-Looking Statements

The following discussion and analysis contains 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, that are based on management's beliefs and assumptions, current expectations, estimates and projections. Such statements, including statements relating to the Company's expectations for future financial performance, are not considered historical facts and are considered forward-looking statements under the federal securities laws. These statements may contain words such as "believes," "anticipates," "plans," "expects," "intends," "estimates" or similar expressions. These statements are not guarantees of the Company's future performance and are subject to risks, uncertainties and other important factors that could cause our actual performance or achievements to differ materially from those expressed or implied by these forward-looking statements and include, without limitation: the effect of our acquisition strategy on future operating results, including our ability to effectively integrate acquired companies into our existing operations; the uncertainty of acceptance of new products and successful bidding for new contracts; the effect of technological changes or obsolescence relating to our products and services; and the effects of government regulation or shifts in government policy, as they may relate to our products and services and other risks or uncertainties detailed in the Company's Securities and Exchange Commission filings. Given these uncertainties, you should not rely on forward-looking statements. The Company undertakes no obligations to update any forward-looking statements, whether as a result of new information, future events or otherwise.

Overview

DRS is a leading supplier of defense electronic products and systems. We provide high-technology products and services to all branches of the U.S. military, major aerospace and defense prime contractors, government intelligence agencies, international military forces and industrial markets. Incorporated in 1968, DRS has served the defense industry for 34 years. We are a leading provider of thermal imaging devices, combat display workstations, electronic sensor systems, power systems, battlefield digitization systems, mission recorders and deployable flight incident

recorders. Our products are deployed on a wide range of high-profile military platforms, such as DDG-51 Aegis destroyers, M1A2 Abrams Main Battle Tanks, M2A3 Bradley Fighting Vehicles, OH-58D Kiowa Warrior helicopters, AH-64 Apache helicopters, F/A-18E/F Super Hornet jet fighters and on several other platforms for military and non-military applications. We also have contracts that support future military platforms, such as the DD(X) destroyer, CVN-21 next generation aircraft carrier and Virginia class submarine.

We have increased our annual revenues and operating income at compounded annual growth rates of 30% and 36%, respectively, over the last five years. In addition, from fiscal 2002 to fiscal 2003, operating income increased 36% and net earnings increased 48%. For the year ended March 31, 2003, we generated revenues of \$675.8 million and operating income of \$67.7 million.

Funded backlog increased substantially in fiscal 2003, primarily as a result of our acquisitions. At March 31, 2003, our funded backlog was approximately \$867.1 million, an increase of 46% from March 31, 2002. As of March 31, 2003, 36% and 30% of our backlog related to products and services for the U.S. Army and U.S. Navy, respectively, as compared with 53% and 23% at March 31, 2002.

Company Organization and Products

We operate in three principal operating segments on the basis of products and services offered: the Electronic Systems Group, the Electro-Optical Systems Group and the Flight Safety and Communications Group. Each operating segment is comprised of separate and distinct businesses. All other operations are grouped in Other.

Our Electronic Systems Group (ESG) is a leader in high-performance combat display systems, digital information processing systems, power generation, conversion, distribution, propulsion and control systems, and battlefield digitization systems for sea, air and land applications supporting military modernization and transformation initiatives. ESG also produces radar surveillance and tracking systems, acoustic signal processing systems, flat panels and other computer peripherals, signal intelligence products, ship networks and middleware to promote interoperability and compatibility with the military's new and existing systems. ESG's products are used on various front-line platforms, such as ships, amphibious operation platforms, surveillance aircraft and submarines and mobile ground platforms, and our power systems are installed on every combatant ship in the U.S. Navy, including destroyers, aircraft carriers and attack submarines. ESG is a leader in battlefield digitization programs for the U.S. Army and the British Army. The Group also provides technical support services, including worldwide field service, depot-level repair, equipment installation and integrated logistics for the Navy's fleet, avionics support for

U.S. and international helicopter and airlift aircraft, hardware and software system engineering, and electronic manufacturing, testing and system integration services.

ESG provided \$291.8 million, or 43% of total revenues, for the year ended March 31, 2003.

Our Electro-Optical Systems Group (EOSG) is a leader in second-generation electro-optical infrared sighting, surveillance, targeting and weapons guidance systems, assemblies and components used in the aerospace and defense industry and is one of only two key suppliers to the U.S. government for advanced focal plane array sensor technology. EOSG product designs are based on infrared cooled and uncooled sensor system technologies. EOSG designs, manufactures and markets these systems to allow operators to detect, identify and track targets based on their infrared signatures regardless of the ambient light level. The Group's cooled systems, which utilize advanced detectors and cryogenic cooler assemblies, are used on the most critical front-line ground vehicle, surface ship and weapons system platforms of the U.S. Army, Navy and Marine Corps, including the M1A2 Abrams Main Battle Tanks, M2A3 Bradley Fighting Vehicles, OH-58D Kiowa Warrior helicopters, AH-64 Apache helicopters, DDG Aegis class destroyers and cruisers, Javelin Missile Systems and the HMMWV Scout vehicles. EOSG's uncooled sighting systems are lighter weight, less expensive thermal imaging systems used for man-portable weapons, transportable gimbals, head-gear, hand-held devices and vehicle-mounted sights for enhancement of driver vision. EOSG also produces medium-range Unmanned Aerial Vehicles (UAVs) and seeks to incorporate DRS's core technologies, such as computer display systems, electro-optical and infrared sensors and targeting systems, high-speed digital cameras, data recording, communications and other intelligence gathering equipment, onto these platforms to support special military operations, surveillance and targeting missions, payload drops and civil applications.

EOSG provided \$276.4 million, or 41% of total revenues, for the year ended March 31, 2003.

Our Flight Safety and Communications Group (FSCG) is a leader in deployable flight incident recorders and emergency locator beacon systems used by military and commercial search and rescue platforms to locate downed aircraft. FSCG also is a leader in the supply of Link 11 data transmission products supporting coordinated theater warfare and enhanced tactical command and control operations. FSCG provides tactical data link communication products, secure modems, telephonic products and next-generation secure voice and data communications systems for advanced digital communications networks. These technologies support the crucial exchange of tactical command and control data with ship, shore and air platforms and have applicability to a Joint Fires Network to support a network-centric warfare system for real-time intelligence correlation, sensor control, target generation, mission planning and battle damage assessment. The Group also designs and produces fully integrated

non-secure Naval ship communication systems, ground radar surveillance systems, infrared search and track systems, aircraft mission recording systems, aircraft weapons calibration systems and high-speed digital imaging systems for U.S. and international defense, aerospace and commercial customers. FSCG's equipment operates on board a wide range of U.S., Canadian and other international surface ships, carriers, fixed-wing aircraft, helicopters, ground vehicles, soldier systems and commercial space-based platforms. In addition, FSCG provides electronic manufacturing services to the defense, aerospace, commercial and space industries.

FSCG provided \$106.3 million, or 16% of total revenues, for the year ended March 31, 2003.

Other includes the activities of DRS Corporate Headquarters, DRS Ahead Technology (for the period it was owned by us during the first quarter of fiscal 2003) and certain non-operating subsidiaries of the Company. DRS Ahead Technology produced magnetic head components used in the manufacturing process of computer disk drives, which burnish and verify the quality of disk surfaces. DRS Ahead Technology also serviced and manufactured magnetic video recording heads used in broadcast television equipment. The assets of DRS Ahead Technology were sold on May 27, 2002 (see Acquisitions and Divestitures below).

Acquisitions and Divestitures

The following summarizes certain acquisitions and divestitures we completed which significantly affect the comparability of the period-to-period results presented in this discussion and analysis. The acquisitions discussed below have been accounted for using the purchase method of accounting. Accordingly, the results of operations of the acquired businesses are included in our reported operating results from their respective effective dates of acquisition. We selectively target acquisition candidates that complement or expand our product lines, services or technical capabilities. We continue to seek acquisition opportunities consistent with our overall business strategy.

Fiscal 2003 Acquisitions On February 14, 2003, we acquired all of the outstanding stock of Power Technology Incorporated, a privately held company principally located in Fitchburg, Massachusetts, for \$35.0 million in cash, subject to adjustment, plus \$14.0 million of contingent consideration and \$1.5 million of acquisition-related costs. Renamed DRS Power Technology, Inc. (DRS PTI), the company operates as part of our ESG operating segment. DRS PTI designs, develops, manufactures and provides life-cycle support for a wide variety of high-performance, complex power systems and rotating machinery and is concentrated in four major areas: Navy Electric Drive Equipment, Navy Main Propulsion Turbines, High-Performance Navy Pumps, and Fuel Cells and Industrial Equipment. The addition of DRS PTI to DRS's existing power

systems line of business is a significant part of our strategy of providing Naval vessels with a totally integrated gas turbine or steam turbine propulsion plant, either electric or mechanical drive, and is expected to enhance our ability to expand our involvement in other electric drive platforms supporting Navy growth initiatives.

On January 15, 2003, we acquired the assets and certain liabilities of the Electromagnetics Development Center of Kaman Aerospace, a subsidiary of Kaman Corporation, located in Hudson, Massachusetts, for \$27.5 million in cash, subject to adjustment, plus \$7.5 million of contingent consideration and \$1.2 million of acquisition-related costs. Kaman's Electromagnetics Development Center develops high-performance, lightweight electric motors, generators and drive electronics for defense, industrial and transportation applications. Renamed DRS Electric Power Technologies, Inc. (DRS EPT), the company operates as part of our ESG operating segment. The addition of DRS EPT is complementary to our existing position in ship electric propulsion equipment, control equipment, high-performance networks, tactical displays and specialty reactor plant instrumentation.

On November 27, 2002, a wholly-owned subsidiary of DRS merged with and into Paravant Inc. (Paravant), with Paravant being the surviving corporation and continuing as a wholly-owned subsidiary of DRS. Consideration in the Paravant acquisition was approximately \$94.7 million in cash and the assumption of \$15.5 million in debt. In addition to the purchase price, the estimated costs related to the acquisition, including professional fees, approximated \$5.0 million. Paravant, which consists of five operating units, is a designer and manufacturer of highly engineered, technically advanced, defense electronics for U.S. and allied international military and intelligence agency applications. The company manufactures rugged computer systems and communications interfaces serving military Command, Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance (C4ISR) initiatives. Paravant also produces high-speed processing equipment for the intelligence community and offers modernization design and installation services for select rotary- and fixed-wing military aircraft. The Paravant acquisition is highly compatible with the Company's goals of expanding its core tactical systems business base and increasing our presence in the U.S. Air Force and high-end signal intelligence programs supporting government agencies. The acquired Paravant operating units are managed as part of our ESG operating segment.

On October 15, 2002, we acquired DKD, Inc. (which operated under the name Nytech) for \$13.0 million plus contingent consideration. The \$13.0 million consists of a \$5.0 million cash payment and an \$8.0 million promissory note, bearing interest at a rate of 6%, with payments of \$5.0 million and \$3.0 million due on the first and second anniversaries of the closing, respectively. In addition to the purchase price, the estimated costs related to the acquisition, including professional fees, approximated \$0.5 million. Renamed DRS Nytech Imaging Systems, Inc. and

located in Irvine, California, the company manufactures and markets uncooled thermal imaging systems for portable weapons, head gear, hand-held devices and vehicle-mounted sights. The business also specializes in the design of stabilized, lightweight gimbals capable of controlling numerous sensors and suitable for mounting on a variety of land, sea and air platforms. The Nytech acquisition enhances our position as a supplier of lightweight thermal imaging systems and supports our objectives to further expand its position in the uncooled infrared technology market. DRS Nytech operates as part of EOSG.

Pursuant to a purchase agreement effective July 1, 2002, we acquired the assets and assumed certain liabilities of the Navy Controls Division (NCD) of Eaton Corporation for \$96.0 million in cash. In addition to the purchase price, the estimated costs related to the acquisition, including professional fees, approximated \$3.5 million. Renamed DRS Power & Control Technologies, Inc. (DRS PCT) and located in Milwaukee, Wisconsin, and Danbury, Connecticut, the company is a leading supplier of high-performance power conversion and instrumentation and control systems for the U.S. Navy's combatant fleet, including nuclear-powered and conventionally-powered ships, as well as for specialized industrial customers. Products include ship electric propulsion equipment, power electronics equipment, high-performance networks, shipboard control equipment and control panels, tactical displays, and specialty reactor instrumentation and control equipment. The addition of this unit complements our presence in Naval advanced command and control, computer display and other ship systems. DRS PCT is managed as part of our ESG operating segment.

On April 11, 2002, we acquired the assets of the U.S.-based Unmanned Aerial Vehicle (UAV) business of Meggitt Defense Systems—Texas, Inc., a unit of Meggitt PLC, for \$0.8 million in cash. In addition to the purchase price, the costs related to the acquisition were approximately \$0.2 million. The business, located in Mineral Wells, Texas, and now operating as DRS Unmanned Technologies, Inc., provides close-range, low-weight, low-noise, medium-duration UAVs supporting military special operations missions. Applications for these products include tactical short-range surveillance, radio relay and C4ISR. DRS Unmanned Technologies, Inc. is managed as part of our EOSG operating segment.

Fiscal 2002 Acquisitions On September 28, 2001, we acquired certain assets and liabilities of the Sensors and Electronic Systems business of The Boeing Company (SES business). We paid approximately \$60.1 million in cash, net of a \$7.0 million favorable working capital adjustment received in the fourth quarter of fiscal 2002 for the acquisition. In addition to the purchase price, the costs related to the acquisition, including professional fees, approximated \$4.0 million. SES, located in Anaheim, California, is a leading provider of advanced electro-optical airborne and Naval surveillance and targeting systems, high-performance military

infrared cooled sensor systems, and infrared uncooled sensor products for military and commercial applications. Production, engineering and management of the contracts acquired in the SES acquisition have been assigned, based on operational synergies, to two previously existing EOSG operating units, as well as a new operating unit called DRS Sensors & Targeting Systems, Inc. (DRS STS). DRS STS was created as a result of the SES acquisition, and it is also an operating unit of our EOSG operating segment. This acquisition broadens the product lines and customer base of EOSG, particularly in those areas associated with Naval and air-based applications, and provides a strong complement to our existing products in ground-based forward looking infrared technology.

On August 22, 2001, we acquired certain assets and liabilities of the Electro Mechanical Systems unit of Lockheed Martin Corporation for \$4.0 million in cash, subject to adjustment, and \$0.3 million in acquisition-related costs. Located in Largo, Florida, this company now operates as DRS Surveillance Support Systems, Inc. (DRS SSS), a unit of our ESG operating segment. DRS SSS produces pedestals, support systems and antennae for radar and other surveillance sensor systems.

Fiscal 2001 Acquisition On June 14, 2000, we acquired the assets of General Atronics Corporation for \$7.5 million in cash, \$4.0 million in common stock, representing 355,359 shares of DRS common stock, and \$0.4 million in acquisition-related costs. Located in Wyndmoor, Pennsylvania, and now operating as DRS Communications Company, LLC (DRS Communications Company), the company designs, develops and manufactures military data link components and systems, high-frequency communication modems, tactical and secure digital telephone components, and radar surveillance systems for U.S. and international militaries. DRS Communications Company is managed as part of our FSCG operating segment.

Fiscal 2003 Divestitures On November 22, 2002, we sold our DRS Advanced Programs, Inc. (DRS API) operating unit for \$7.6 million in cash and recorded a \$0.6 million loss on the sale. DRS API, which operated as part of our ESG operating segment, developed, designed, manufactured and marketed custom-packaged computers and peripherals, primarily for the Department of Defense and the government intelligence community. The results of operations of DRS API, prior to the sale, are summarized as follows:

(in thousands)	Year Ended March 31,		
	2003	2002	2001
Revenues	\$ 8,507	\$15,843	\$12,784
Operating (loss) income	\$(1,067)	\$ 125	\$ (101)

On May 27, 2002, we sold the assets of our DRS Ahead Technology operating unit. The operating unit produced magnetic head components used in the manufacturing process of computer disk drives and manufactured magnetic video recording heads used in broadcast television equipment. No gain or loss was recorded on the sale. The results of operations of DRS Ahead Technology, prior to the sale, are summarized as follows:

(in thousands)	Year Ended March 31,		
	2003	2002	2001
Revenues	\$1,349	\$9,209	\$9,651
Operating (loss) income	\$ (496)	\$ (369)	\$ 70

Critical Accounting Policies

During fiscal 2002, the Securities and Exchange Commission (SEC) issued disclosure guidance for "critical accounting policies." The SEC defines critical accounting policies as those that require application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods.

The following is not intended to be a comprehensive list of all of our accounting policies. Our significant accounting policies are more fully described in Note 1 of Notes to Consolidated Financial Statements. In many cases, the accounting treatment of a particular transaction is specifically dictated by accounting principles generally accepted in the United States of America, with no need for management's judgment in their application. Other areas require management's judgment to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenues and costs and expenses during the reporting period. Ultimately, actual amounts may differ from these estimates. We believe that critical accounting estimates have the following attributes: (1) we are required to make assumptions about matters that are highly uncertain at the time of the estimate; and (2) different estimates we could reasonably have used, or changes in the estimates that are reasonably likely to occur, would have a material effect on our financial condition or results of operations. We believe the following critical accounting policies contain the more significant judgments and estimates used in the preparation of our financial statements.

Revenue Recognition on Contracts and Contract Estimates

Substantially all of our direct and indirect sales to the U.S. government and certain of our sales to foreign governments and commercial customers are made pursuant to written contractual arrangements or "contracts" to design, develop, manufacture

and/or modify complex products to the specifications of the buyers (customers) or to provide services related to the performance of such contracts. These contracts are accounted for in accordance with American Institute of Certified Public Accountants Statement of Position 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts" (SOP 81-1), and cost-reimbursable contracts with the U.S. government also are specifically accounted for in accordance with Accounting Research Bulletin No. 43, Chapter 11, Section A, "Government Contracts, Cost-Plus-Fixed Fee Contracts" (ARB 43).

Revenues and profits on fixed-price contracts are recognized using percentage-of-completion methods of accounting. Revenues and profits on fixed-price production contracts whose units are produced and delivered in a continuous or sequential process are recorded as units are delivered based on their selling prices (the "units-of-delivery" method). Revenues and profits on other fixed-price contracts are recorded based on the ratio of total actual incurred costs to date to the total estimated costs at completion of the contract for each contract (the "cost-to-cost" method). Under the percentage-of-completion methods of accounting, a single estimated total profit margin is used to recognize profit for each contract over its entire period of performance, which can exceed one year.

Accounting for the revenues and profit on a fixed-price contract requires estimates of (1) the contract value or total contract revenue, (2) the total costs at completion, which is equal to the sum of the actual incurred costs to date on the contract and the estimated costs to complete the contract's scope of work and (3) the measurement of progress towards completion. The estimated profit or loss on a contract is equal to the difference between the total contract value and the estimated total cost at completion. Under the units-of-delivery percentage-of-completion method, revenues on a fixed-price contract are recorded as the units are delivered during the period at an amount equal to the contractual selling price of those units. Under the cost-to-cost percentage-of-completion method, revenues on a fixed-price contract are recorded at amounts equal to the ratio of cumulative costs incurred to date to total estimated costs at completion multiplied by the contract value, less the cumulative revenues recognized in prior periods. The profit recorded on a contract in any period under both the units-of-delivery method and cost-to-cost method is equal to the current estimated total profit margin for the contract stated as a percentage of contract revenue multiplied by the cumulative revenue recorded less the cumulative profit previously recorded. Adjustments to original estimates for a contract's revenues, estimated costs at completion and estimated total profit are often required as work progresses under a contract, as experience is gained and as more information is obtained, even though the scope of work required under the contract may not change, or if contract modifications occur. These changes are recorded on a cumulative catch-up basis in the period they are determined to be necessary.

Revenues and profits on a cost-reimbursable contract are recognized as allowable costs are incurred on the contract and become billable to the customer, in an amount equal to the allowable costs plus the profit on those costs, which generally are fixed- or variable-based on the contract fee arrangement. Thus, cost-reimbursable contracts generally are not subject to the same estimation risks that affect fixed-price contracts.

The impact of revisions in profit estimates on both fixed-price and cost-reimbursable contracts is recognized on a cumulative catch-up basis in the period in which the revisions are made. Provisions for anticipated losses on contracts are recorded in the period in which they become evident. Amounts representing contract change orders or claims are included in revenues only when they can be estimated reliably and their realization is reasonably assured. The revisions in contract estimates, if significant, can materially affect our results of operations and cash flows.

We record contract-related assets and liabilities acquired in business combinations at their fair value by considering the remaining contract amounts to be billed, our estimate to complete and a profit allowance on our completion effort commensurate with the profit margin we earn on similar contracts. Revisions to cost estimates subsequent to the date of acquisition may be recorded as an adjustment to goodwill or earnings, depending on the nature and timing of the revision.

We often enter into contracts that provide for significant engineering as well as the production of finished units with the expectation that we will incur substantial up-front costs to engineer the product to meet customer specifications. These arrangements typically provide us the opportunity to be awarded add-on contracts requiring the delivery of additional finished units. Our ability to recover up-front costs and earn a reasonable overall profit margin often is contingent on our ability to recover the up-front costs over multiple deliverable awards. Prior to entering into such arrangements, we estimate the amount of up-front costs to be incurred and evaluate the likelihood of being awarded the add-on contracts. Inaccurate estimates of up-front costs, coupled with the failure to obtain or delays in obtaining add-on contracts, could have a material effect on the timing of revenue and/or profit recognition.

Goodwill and Intangible Assets In July 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets" (SFAS 142). SFAS 142 requires that goodwill and identifiable acquired intangible assets with indefinite useful lives shall no longer be amortized, but tested for impairment annually and whenever events or circumstances occur indicating that goodwill or indefinite life intangibles might be impaired. SFAS 142 also requires the amortization of identifiable assets with finite useful lives, although the Statement no longer limits the amortization period to forty years. Identifiable acquired

intangible assets, which are subject to amortization, are to be tested for impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (See Long-Lived Assets and Acquired Intangible Assets below). As of March 31, 2003, we had \$436.9 million of goodwill and \$44.8 million of net acquired identifiable intangible assets subject to amortization and no identifiable intangible assets with indefinite lives. In accordance with SFAS 142, goodwill is to be tested for impairment at a level of reporting referred to as a "reporting unit." We have identified four reporting units for impairment testing purposes.

The annual impairment test is performed after completion of our annual financial operating plan, which occurs in the fourth quarter of our fiscal year. We completed our annual impairment tests with no adjustment to the carrying value of our goodwill, as of March 31, 2003 and 2002. The annual goodwill impairment assessment involves estimating the fair values of the four reporting units (three reporting units in fiscal 2002) and comparing such fair values with the reporting unit's respective carrying amount. If the carrying value of the reporting unit exceeds its fair value, additional steps are followed to recognize a potential impairment loss. We estimate the fair value of our reporting units by applying third party market value indicators to the reporting unit's projected revenues, earnings before net interest and taxes (EBIT), and earnings before net interest, taxes, depreciation and amortization (EBITDA), and calculating an average of the three extended values. Estimating the fair value of the reporting units requires significant estimates and assumptions by management, as the calculation is dependent on estimates for future revenues, EBIT and EBITDA, all of which are impacted by economic conditions related to the industries in which we operate, as well as conditions in the U.S. capital markets. A decline in estimated fair value of a reporting unit could result in an unexpected impairment charge to goodwill, which could have a material adverse effect on our business, financial condition and results of operations.

Long-Lived Assets and Acquired Intangible Assets We assess the recoverability of our long-lived assets and acquired identifiable intangible assets with finite useful lives whenever events or changes in circumstances indicate that the carrying value of the asset may not be recoverable. Factors we consider important which could trigger an impairment review include:

- Significant under performance relative to expected historical performance or projected future operating results;
- Significant changes in the manner or use of the assets or the strategy of our overall business;
- Significant adverse changes in the business climate in which we operate; and
- Loss of a significant contract.

If we identify the existence of one or more of the above indicators, we would determine if the asset is impaired by comparing its net undiscounted cash flows to its carrying value. If the expected future net undiscounted cash flows were less than the carrying value of the asset, we would record an impairment loss based on the difference between the asset's estimated fair value and its carrying value.

Valuation of Deferred Tax Assets and Liabilities At March 31, 2003, we had net deferred tax assets of \$3.1 million, including net operating loss carryforwards, which are subject to various limitations and will expire if unused within their respective carryforward periods. As of March 31, 2003, we have provided a \$7.1 million valuation allowance that is included in our net deferred tax assets. Deferred taxes are determined separately for each of our tax paying entities in each tax jurisdiction. Future realization of deferred tax assets ultimately depends on the existence of sufficient taxable income of the appropriate character (for example, ordinary income or capital gain) within the carryback and carryforward periods available under the tax law. Based on our estimates of the amounts and timing of future taxable income, we believe we will realize our recorded net deferred tax assets. A change in the ability of our operations to continue to generate future taxable income could affect our ability to realize the future tax deductions underlying our net deferred tax assets and require us to increase our valuation allowance against our net deferred tax assets. Such changes, if significant, could have a material impact on our effective tax rate, results of operations and financial position in any given period.

Management Estimates The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Some of the more significant estimates made by management involve percentage of completion on long-term contracts, recoverability of long-lived and intangible assets, and the valuation of deferred tax assets and liabilities, as discussed above. We also make estimates regarding the recoverability of assets, including accounts receivable and inventories, and for litigation and contingencies.

A substantial majority of our revenues and, consequently, our outstanding accounts receivables are directly or indirectly with the United States government. Therefore, our risk of not collecting amounts due us under such arrangements is minimal. We generally require letters of credit or deposit payments prior to the commencement of work or obtain progress payments upon the achievement of certain milestones from our commercial

customers. In addition, our revenues are supported by contractual arrangements specifying the timing and amounts of payments. Consequently, we historically have experienced and expect to continue to experience a minimal amount of uncollectible accounts receivable. Changes in the underlying financial condition of our customers or changes in the industry in which we operate necessitating revisions to our standard contractual terms and conditions could have an impact on our results of operations in the future.

Our inventory consists of work-in-process, raw materials and finished goods, including subassemblies principally for use in our products. We continually evaluate the adequacy of our reserves on our raw materials and finished goods inventory by reviewing historical rates of scrap, on-hand quantities, as compared with historical and projected usage levels and other anticipated contractual requirements.

We record a liability pertaining to pending litigation based on our best estimate of potential loss, if any, or at the minimum end of the range of loss in circumstances where the range of loss reasonably can be estimated. Because of uncertainties surrounding the nature of litigation and the cost to us, if any, we continually revise our estimated losses as additional facts become known.

Results of Operations

Our operating cycle is long-term and involves various types of production contracts and varying production delivery schedules. Accordingly, operating results of a particular year, or year-to-year comparisons of recorded revenues and earnings, may not be indicative of future operating results. The following comparative analysis should be viewed in this context.

Fiscal Year Ended March 31, 2003, Compared with Fiscal Year Ended March 31, 2002 Revenues and operating income for the year ended March 31, 2003 were \$675.8 million and \$67.7 million, respectively, increasing \$158.6 million and \$17.9 million, respectively, as compared with the prior fiscal year. The increase in revenues was driven primarily by our fiscal 2003 acquisitions, primarily DRS PCT and Paravant, as well as a complete fiscal year of revenues generated by the SES business acquired in fiscal 2002. DRS PCT and Paravant contributed \$72.4 million and \$23.0 million, respectively, to fiscal 2003 revenues. The SES business contributed an incremental increase (year-over-year increase) of \$35.7 million to revenues for the year ended March 31, 2003. In addition, increased shipments of our ground vehicle electro-optical systems, mission data recorders and avionics contributed to the fiscal 2003 increase in revenues. Partially offsetting the overall increase in revenues were decreases from our combat display workstations, certain rugged computers and peripherals programs, and the sale of DRS Ahead Technology and DRS API. DRS Ahead Technology and DRS API combined recorded revenues of \$9.9 million during fiscal 2003, as compared with

\$25.1 million in fiscal 2002. The growth in operating income was due primarily to the overall increase in revenues and operating margin improvements in our FSCG operating segment. DRS PCT and Paravant contributed \$7.8 million and \$4.1 million, respectively, to operating income in fiscal 2003, while the SES business contributed an incremental increase of \$3.1 million to operating income for the same period. See Operating Segments discussion below for additional information.

Interest income increased slightly to \$1.2 million for the year ended March 31, 2003, as compared with the prior year. The increase in interest income reflects a higher average cash and cash equivalents balance in fiscal 2003, resulting primarily from our common stock offerings in December 2002 and 2001, partially offset by lower average interest rates.

Interest and related expenses decreased slightly to \$10.6 million for the year ended March 31, 2003, as compared with \$11.0 million in the prior fiscal year. Although weighted average borrowings outstanding increased during fiscal 2003 due primarily to the Paravant acquisition, interest expense decreased as a result of an overall decrease in weighted average interest rates during fiscal 2003, as compared with the prior fiscal year. We had no borrowings outstanding under our revolving credit facility as of March 31, 2003 and 2002.

Other expense of \$0.8 million for the year ended March 31, 2003 was primarily driven by foreign currency transaction losses recorded during fiscal 2003.

Minority interest was \$1.6 million for the years ended March 31, 2003 and 2002. Operating income generated by ESG's DRS Laurel Technologies unit, in which we have an 80% interest, decreased slightly year over year.

The provision for income taxes for the year ended March 31, 2003 reflected an annual estimated effective income tax rate of approximately 46%, as compared with 47% in the prior-year period. There are two primary factors that negatively impact our effective income tax rate: losses in ESG's U.K. operation for which the full tax benefit has not been recognized and the effect of non-deductible expenses. It is anticipated that our effective tax rate will continue to decline moderately in future years, as we continue to grow and our ESG U.K. operation returns to profitability.

Earnings before net interest and related expenses (primarily amortization of debt issuance costs), income taxes, depreciation and amortization (EBITDA) for the year ended March 31, 2003 was \$81.9 million, an increase of 32% over the prior fiscal year. See Use of Non-GAAP Financial Measures below.

Fiscal Year Ended March 31, 2002, Compared with Fiscal Year Ended March 31, 2001 Revenues and operating income for the year ended March 31, 2002 were \$517.2 million and \$49.8 million, respectively, increasing \$89.6 million and \$12.2 million, respectively, as compared with the prior fiscal year. The increase in revenues was driven by our fiscal 2002 second quarter acquisitions of the SES business and DRS SSS,

increased shipments of our second generation infrared sighting and targeting systems, and combat display workstations, as well as a complete fiscal year of revenues generated by DRS Communications Company, which we acquired at the end of the first quarter of fiscal 2001. The 33% increase in operating income was due primarily to the overall increase in revenues and the impact of our fiscal 2002 adoption of SFAS 141 and 142 (see Notes 1 and 3 of Notes to Consolidated Financial Statements). In accordance with the provisions of SFAS 142, we ceased amortizing goodwill effective April 1, 2001. Operating income for the year ended March 31, 2001 included \$5.3 million of goodwill amortization. Partially offsetting the increase in operating income was the impact of certain charges at our operating segments. See Operating Segments discussion below for additional information.

Interest income increased \$0.9 million to \$1.1 million for the year ended March 31, 2002, as compared with the prior fiscal period. The increase in interest income reflects a higher average cash and cash equivalents balance in fiscal 2002, as a result of our secondary common stock offering in the third quarter of fiscal 2002.

Interest and related expenses decreased \$0.5 million for the year ended March 31, 2002, as compared with the prior fiscal year. The decrease in interest expense in fiscal 2002 was primarily the result of an overall decrease in average working capital borrowings outstanding during the year, the favorable impact of the conversion of all of our 9% Senior Subordinated Convertible Debentures during the

second half of fiscal 2001 and an overall decrease in weighted average interest rates in fiscal 2002, as compared with fiscal 2001. The overall decrease in average working capital borrowings in fiscal 2002 was due to our repayments of amounts outstanding under our revolving credit line with proceeds from our secondary common stock offering. As of March 31, 2002, we had no borrowings outstanding under our revolving credit facility. Partially offsetting the overall decrease in interest and related expenses were interest charges of \$1.6 million associated with actual and estimated working capital adjustments in connection with certain previous acquisitions (see Note 3 of Notes to Consolidated Financial Statements).

Minority interest was \$1.6 million and \$1.4 million in fiscal 2002 and 2001, respectively. The increase was due to higher operating income generated by ESG's DRS Laurel Technologies unit.

The provision for income taxes for the year ended March 31, 2002 reflected an annual estimated effective income tax rate of 47%, as compared with 52% in the prior fiscal year. The decrease in our effective tax rate was primarily due to the cessation of goodwill amortization pursuant to the adoption of SFAS 142. It is anticipated that our effective tax rate will decline moderately in future years as we continue to grow.

EBITDA for the year ended March 31, 2002 was \$62.0 million, an increase of 18% over the prior fiscal year (see Use of Non-GAAP Financial Measures below).

Operating Segments

The following tables set forth, by operating segment, revenues, operating income, operating margin, depreciation and amortization, and the percentage increase or decrease of those items, as compared with the prior-year period:

(\$ in thousands)	Year Ended March 31,			Percent Changes	
	2003	2002	2001	2003 vs. 2002	2002 vs. 2001
ESG					
Revenues*	\$291,756	\$206,617	\$186,474	41.2%	10.8%
Operating income	\$ 18,733	\$ 18,053	\$ 15,336	3.8%	17.7%
Operating margin	6.4%	8.7%	8.2%	(26.5%)	6.2%
Depreciation and amortization	\$ 4,403	\$ 1,914	\$ 3,447	130.0%	(44.5%)
EOSG					
Revenues*	\$276,363	\$208,221	\$148,162	32.7%	40.5%
Operating income	\$ 37,168	\$ 27,365	\$ 23,646	35.8%	15.7%
Operating margin	13.4%	13.1%	16.0%	2.3%	(17.7%)
Depreciation and amortization	\$ 8,630	\$ 7,153	\$ 6,972	20.6%	2.6%
FSCG					
Revenues*	\$106,294	\$ 93,153	\$ 83,319	14.1%	11.8%
Operating income (loss)	\$ 12,605	\$ 5,090	\$ (747)	147.6%	N/A
Operating margin	11.9%	5.5%	(0.9%)	117.0%	N/A
Depreciation and amortization	\$ 2,300	\$ 2,907	\$ 4,029	(20.9%)	(27.8%)
Other					
Revenues*	\$ 1,349	\$ 9,209	\$ 9,651	(85.4%)	(4.6%)
Operating loss	\$ (822)	\$ (739)	\$ (704)	(11.2%)	(5.0%)
Operating margin	(60.9%)	(8.0%)	(7.3%)	(659.3%)	(10.0%)
Depreciation and amortization	\$ 1,327	\$ 1,815	\$ 1,797	(26.9%)	1.0%

* Revenues are net of intersegment eliminations.

Fiscal Year Ended March 31, 2003, Compared with Fiscal Year Ended March 31, 2002

Electronic Systems Group Revenues increased \$85.1 million, or 41%, to \$291.8 million in fiscal 2003, as compared with the prior fiscal year. Operating income increased \$0.7 million, or 4%, to \$18.7 million. The increase in revenues was driven by the DRS PCT and Paravant acquisitions, which contributed revenues of \$72.4 million and \$23.0 million, respectively, as well contributions from our fiscal 2003 fourth quarter acquisitions of DRS PTI and DRS EPT. Also favorably impacting revenues were increased sales of rugged computers and multi-function consoles from our U.K. operating unit, as well as shipments of certain surface search radar systems. Partially offsetting the overall increase in revenues were decreased shipments of combat display workstations and related engineering volume, and certain rugged computers and peripherals under the U.S. Army's Common Hardware/Software II (CH/S-2) program. The increase in operating income was driven primarily by the fiscal 2003 acquisitions, offset in part by the unfavorable impact of decreased revenue from certain products, particularly the CH/S-2 related programs that have traditionally earned higher margins. Fiscal 2003 operating income also was unfavorably impacted by charges of \$2.2 million and \$1.8 million for cost growth on a surface search radar program and for certain charges at the Group's U.K. operating unit, respectively. ESG's U.K. operating unit's charges included \$1.5 million for cost growth and inventory write-offs on certain programs, and \$0.3 million for reorganization costs. DRS PCT and Paravant contributed \$7.8 million and \$4.1 million, respectively, to operating income in fiscal 2003.

Electro-Optical Systems Group Revenues increased \$68.1 million, or 33%, to \$276.4 million in fiscal 2003, as compared with the prior fiscal year. Operating income increased \$9.8 million to \$37.2 million. The increase in revenues was driven by \$35.7 million of incremental revenue growth from programs acquired in connection with our fiscal 2002 second quarter acquisition of the SES business. In addition, our fiscal 2003 acquisitions of DRS Nytech and DRS Unmanned Technologies, Inc. and growth in our second generation infrared targeting and imaging systems programs, particularly the Long Range Advanced Scout Surveillance System (LRAS3) and Improved Bradley Acquisition Subsystem (IBAS) programs, contributed to the overall increase in revenues. Partially offsetting the increase in revenues was a decrease in shipments of Horizontal Technology Integration (HTI) related systems. The increase in fiscal 2003 operating income, as compared with the prior fiscal year, was primarily due to the overall increase in revenues, as well as the incremental increase of \$3.1 million from the SES programs.

Flight Safety & Communications Group Revenues increased \$13.1 million, or 14%, to \$106.3 million in fiscal 2003, as compared with the prior fiscal year. Operating income increased \$7.5 million, or 148%, to \$12.6 million. Increased shipments of mission data recording systems, avionics products and certain communication and surveillance systems were the primary reasons for the increase in revenues. Decreased revenues recognized on advanced manufacturing systems partially offset the overall increase in revenues. The increase in operating income was a result of higher revenues and favorable margins on advance manufacturing services. Operating income for the year ended March 31, 2003 included charges of \$2.0 million, \$1.1 million and \$1.2 million for program reserves on a mission data recorder program, additional costs associated with closing FSCG's Santa Clara, California production and engineering facility, and reorganization charges in the operating group's Canadian and U.K. operating subsidiaries, respectively. Operating income for the year ended March 31, 2002 included charges of \$2.5 million, \$1.3 million and \$1.2 million for the settlement of litigation, cost growth on a mission data recorder program and costs incurred in connection with closing FSCG's Santa Clara, California production and engineering facility, respectively (see FSCG prior-year discussion below).

Other Revenues decreased \$7.9 million to \$1.3 million, and operating losses increased \$0.1 million to \$0.8 million in fiscal 2003, as compared with the prior fiscal year. The decrease in revenues was attributable to our sale of substantially all of the assets and liabilities of DRS Ahead Technology on May 27, 2002 (see Note 2 of our Notes to Consolidated Financial Statements). The increase in operating losses was due to DRS Ahead Technology generating a greater loss for the period of time that we owned them in fiscal 2003, as compared with fiscal 2002.

Fiscal Year Ended March 31, 2002, Compared with Fiscal Year Ended March 31, 2001

Electronic Systems Group Revenues increased \$20.1 million, or 11%, to \$206.6 million in fiscal 2002, as compared with the prior fiscal year. Operating income increased \$2.7 million, or 18%, to \$18.1 million. Revenues increased primarily as a result of internal growth from our combat display workstations and components, as well as the inclusion of \$8.0 million of revenue contributed by DRS SSS, which we acquired during the second quarter of fiscal 2002. These increases were partially offset by decreases in revenues from certain search and navigation radar systems, and rugged computers and peripherals sold to international militaries. The increase in fiscal 2002 operating income resulted from the net increase in revenues and the

favorable impact of the elimination of goodwill amortization, due to the adoption of SFAS 142, partially offset by operating margin decreases on certain search and navigation radar systems. DRS SSS contributed \$0.9 million to fiscal 2002 operating income. ESG's fiscal 2001 operating income included \$1.9 million of goodwill amortization.

Electro-Optical Systems Group Revenues increased \$60.1 million, or 41%, to \$208.2 million in fiscal 2002, as compared with the prior fiscal year. Operating income increased \$3.7 million to \$27.4 million. The increase in revenues was driven by growth in our second generation infrared targeting and imaging systems programs, and \$45.1 million in revenues generated by programs acquired with our purchase of the SES business at the end of the second quarter of fiscal 2002. The increase in fiscal 2002 operating income, as compared with the prior fiscal year, was due primarily to \$4.3 million of operating income contributed by the SES business, as well as the positive impact of the elimination of goodwill amortization. Fiscal 2002 and 2001 operating income reflected \$1.7 million and \$7.0 million, respectively, of net favorable program adjustments on certain long-term programs. EOSG's fiscal 2001 operating income included \$2.1 million of goodwill amortization.

Flight Safety & Communications Group Revenues increased \$9.8 million, or 12%, to \$93.2 million in fiscal 2002, as compared with the prior fiscal year. Operating income increased \$5.8 million to \$5.1 million. The revenue increase was driven primarily by the inclusion of a full year of revenues generated by DRS Communications Company, which we acquired at the end of the first quarter of fiscal 2001, greater volume of contract manufacturing services, and shipments of infrared search and tracking systems. The year-over-year growth in operating income was a result of the overall increase in revenues and the elimination of goodwill amortization. Fiscal 2002 operating income reflected charges of \$2.5 million, \$1.3 million and \$1.2 million for the settlement of litigation (see Industry/Business Considerations below), cost growth on a mission data recorder program and costs incurred in connection with closing FSCG's Santa Clara, California production and engineering facility, respectively. Fiscal 2001 includes charges attributed to several matters: a \$1.3 million charge for estimated excess inventories associated with a specific product line for which the anticipated future sales are less than previously estimated; a \$1.0 million charge for a contract pricing dispute between us and a prime contractor on a U.S. Navy program; and a charge of \$1.9 million for additional costs incurred to complete the development of a mission data recording system for the U.S. Navy. FSCG's fiscal 2001 operating income included \$1.3 million of goodwill amortization.

Other Revenues decreased \$0.4 million to \$9.2 million, and operating losses were flat at \$0.7 million in fiscal 2002. The decrease in revenues resulted from weaker sales at our DRS Ahead Technology operating unit. We sold our DRS Ahead Technology unit on May 27, 2002 (see Note 2 of Notes to Consolidated Financial Statements). Fiscal 2001 operating income included a \$1.1 million charge for a potentially uncollectible note receivable.

Liquidity and Capital Resources

Cash Flows The following table provides our cash flow data for the fiscal years ended March 31, 2003, 2002 and 2001:

(in thousands)	Year Ended March 31,		
	2003	2002	2001
Net cash provided by operating activities	\$ 52,008	\$ 27,849	\$ 34,270
Net cash used in investing activities	\$(278,721)	\$(84,943)	\$(19,655)
Net cash provided by (used in) financing activities	\$ 204,398	\$172,565	\$(16,056)

Cash and cash equivalents, internally generated cash flow from operations and other available financing resources are expected to be sufficient to meet anticipated operating, capital expenditure and debt service requirements during the next 12 months and the foreseeable future. Consistent with our desire to generate cash to invest in our core businesses and reduce debt, we anticipate that, subject to prevailing financial, market and economic conditions, we may divest certain non-core businesses. There can be no assurance, however, that our business will continue to generate cash flow at current levels, or that anticipated operational improvements will be achieved. If we are unable to generate sufficient cash flow from operations to service our debt, we may be required to sell assets, reduce capital expenditures, refinance all or a portion of our existing debt or obtain additional financing. Our ability to make scheduled principal payments or pay interest on or refinance our indebtedness depends on our future performance and financial results, which, to a certain extent, are subject to general conditions in or affecting the defense industry and to general economic, political, financial, competitive, legislative and regulatory factors beyond our control.

Operating Activities During fiscal 2003, we generated \$52.0 million of operating cash flow, \$24.2 million more than the \$27.8 million reported in the prior fiscal year. Net earnings increased by \$9.8 million to \$30.2 million. Adjustments to reconcile net earnings to cash flows from operating activities increased \$10.0 million over the prior fiscal year. Depreciation and amortization increased mainly due to our increased investment in our manufacturing facilities and equipment to upgrade our existing infrastructure and to integrate recent acquisitions into our existing businesses. Net deferred tax assets for fiscal 2003, as compared with fiscal 2002, decreased because of smaller estimated tax deductions arising from our recently completed acquisitions.

Non-cash increases to our inventory and accounts receivable reserves increased in fiscal 2003, as compared with fiscal 2002. Fiscal 2003 also included the loss incurred on the sale of our DRS API operating unit. The cash used by working capital accounts resulted from a net decrease in certain current liabilities, which included a payment of \$2.5 million associated with the settlement of litigation, and increases in accounts receivable due to high sales volume in the fourth quarter, offset, in part, by advances received from customers and lower inventory balances.

Investing Activities The following table summarizes the cash flow impact of our business combinations for the years ended March 31, 2003, 2002 and 2001:

(\$ in thousands)	Effective Date of Transaction	Net Cash Paid	Acquisition Expenses	Total
Fiscal 2003 Business Combinations				
U.S. UAV Business of Meggitt Defense Systems	04/11/02	\$ 750	\$ 122	\$ 872
Navy Controls Division of Eaton Corporation	07/01/02	96,025	2,642	98,667
DKD, Inc. (Nytech)	10/15/02	3,383	161	3,544
Paravant Inc.	11/27/02	94,744	3,259	98,003
Kaman Electromagnetics Development Center	01/15/03	27,515	31	27,546
Power Technology Incorporated	02/14/03	33,233	216	33,449
Fiscal 2003 business combinations		255,650	6,431	262,081
Spar Aerospace Ltd. – working capital adjustment (A)		2,977	—	2,977
Total payments pursuant to business combinations		<u>\$258,627</u>	<u>\$6,431</u>	<u>\$265,058</u>
Fiscal 2002 Business Combinations				
SES Business of The Boeing Company	09/28/01	\$ 60,138	\$3,470	\$ 63,608
Electro Mechanical Systems unit of Lockheed Martin Corp.	08/22/01	4,000	175	4,175
Fiscal 2002 business combinations		64,138	3,645	67,783
EOS Business of Raytheon Company – working capital adjustment (B)		3,823	—	3,823
Total payments pursuant to business combinations		<u>\$ 67,961</u>	<u>\$3,645</u>	<u>\$ 71,606</u>
Fiscal 2001 Business Combinations				
General Atronics Corporation	06/14/00	\$ 6,979	\$ 395	\$ 7,374

(A) Represents working capital payment made to Spar Aerospace Ltd. in December, 2002.

(B) Represents working capital payment made to Raytheon Company in February, 2002.

The following table summarizes the sales of our businesses that impacted net cash used in investing activities for the years ended March 31, 2003 and 2001:

(\$ in thousands)	Date of Transaction	Cash Received
Fiscal 2003 Divestitures		
DRS Advanced Programs, Inc.	11/22/02	\$7,624
Fiscal 2001 Divestitures		
DRS Magnetic Tape Head business	08/31/00	\$3,000

Our long-term growth strategy includes a disciplined program of acquiring companies that are both strategic and expected to be accretive to our earnings. Continuation of our acquisition program will depend, in part, on the availability of financial resources at a cost of capital that is acceptable to us. We would expect to utilize cash generated by operations, as well as cash available under our Credit Facility, which also may include the renegotiation of our credit limit to finance such acquisitions. Other sources of capital could include proceeds from a sale of our common stock and the placement of convertible or high-yield debt. We continually evaluate the capital markets climate and may access such markets when the circumstances appear favorable to us. We believe that sufficient capital resources will be available to us from one or several of these sources to finance future acquisitions that we believe to be strategic and accretive to our net earnings. However, no assurances can be made that such financing will be available and at a cost that is acceptable to us, that we will identify acceptable acquisition candidates, or that such acquisitions will be accretive to earnings.

We paid \$21.5 million for capital improvements made primarily to our manufacturing facilities and equipment during fiscal 2003, as compared with \$13.6 million and \$16.2 million for the fiscal years ended 2002 and 2001, respectively. We expect to increase capital expenditures to approximately \$25-\$35 million in fiscal 2004, as we continue to upgrade our facilities and integrate recent acquisitions into our existing businesses.

Financing Activities For the fiscal year ended March 31, 2003, financing activities provided \$204.4 million. Sources of cash included our December 20, 2002 issuance of approximately 5.5 million shares of our common stock at \$28.00 per share, resulting in net proceeds of \$144.3 million after underwriting discounts and professional fees, and \$75.0 million in new term loans drawn down from our amended and restated credit agreement. Uses of cash included the retirement of \$12.0 million in term debt acquired in the Paravant acquisition, \$2.0 million in scheduled payments on our long-term debt, primarily related to our term loans, and \$2.3 million for costs related to our new Credit Facility. We also borrowed and repaid \$6.5 million under our senior secured revolving line of credit.

On November 26, 2002, we entered into a \$338.6 million amended and restated credit agreement (the Credit Facility) with Wachovia Bank, N.A. as the Administrative Agent to fund the Paravant acquisition. The Credit Facility consists of a \$125.0 million senior secured revolving line of credit and a \$213.6 million senior secured term loan facility. The maturity dates of the term loan and the revolving line of credit are September 30, 2008 and September 30, 2006, respectively. The term loan requires quarterly principal payments of \$537,500 through September 30, 2007 and four equal quarterly payments of \$50.7 million thereafter ending on September 30, 2008. The Credit Facility is secured by a lien on substantially all of our assets.

Borrowings under this Credit Facility bear interest, at our option, at either: a "base rate," as defined in the credit agreement, equal to the higher of 0.50% per annum above the latest prime rate and federal funds rate plus a spread ranging from 1.25% to 2.25% per annum, depending on our Total Leverage Ratio (TLR) at the time of determination; or a LIBOR rate, as defined in the Credit Facility, plus a spread ranging from 2.25% to 3.25% per annum, depending on our TLR. The TLR is defined as total debt minus performance-based letters of credit, as compared with EBITDA, as defined in the credit agreement. We pay commitment fees calculated on the average daily unused portion of our revolving line of credit at a rate of 0.50% per annum, provided that the amount of outstanding swing line loans, as defined in the credit agreement, shall not be considered usage of the revolving line of credit for the purpose of calculating such commitment fee. We pay commissions and issuance fees on our outstanding letters of credit and are obligated to pay or reimburse the issuing lender of any letters of credit for such normal and customary costs and expenses incurred or charged by the issuing lender in issuing, effecting payment under, amending or otherwise administering any letter of credit. Letter-of-credit commissions are calculated at a rate ranging from 2.25% to 3.00% per annum, depending on our TLR ratio at the time of issuance, multiplied by the face amount of such letter of credit. Letter-of-credit issuance fees are charged at 0.125% per annum, multiplied by the face amount of such letter of credit. Both letter-of-credit commissions and issuance fees are paid quarterly.

We previously had a \$240 million credit agreement with a syndicate of lenders, with Wachovia Bank, N.A. as the Lead Lender, consisting of a term loan in the aggregate principal amount of \$140 million and a \$100 million revolving line of credit. Repayment terms, collateral, interest rates and other charges under the previous facility were substantially the same as those pursuant to the amended and restated credit agreement described above.

There are certain covenants and restrictions placed on us under our Credit Facility, including a maximum TLR and a minimum fixed-charge ratio, as defined in the credit agreement, a maximum amount of capital expenditures, a restriction on the payment of dividends on our capital stock, a limitation on the issuance of additional debt, a requirement that the Company offer to make prepayments on its term loans outstanding with 50% of the aggregate net cash proceeds from any equity offering if our adjusted leverage ratio, as defined, exceeds 2.00 to 1.00, and certain other restrictions. We were in compliance with all covenants under our Credit Facility at March 31, 2003. Amounts available under the revolving line of credit are based upon a borrowing base calculation, as defined in the credit agreement, which is primarily based on accounts receivable and inventory balances. As of March 31, 2003, we had \$99.5 million of additional available credit, after satisfaction of our borrowing base requirement.

As of March 31, 2003, \$212.5 million of term loans was outstanding against the Credit Facility, in addition to which \$25.5 million was contingently payable under letters of credit, as compared with amounts outstanding and contingently payable at March 31, 2002 of \$139.3 million and \$11.6 million, respectively, under the previous facility. The effective interest rates on the term loans were 4.4% and 5.3% as of March 31, 2003 and 2002, respectively. We enter into standby letter-of-credit agreements with financial institutions and customers primarily relating to the guarantee of our future performance on certain contracts to provide products and services and to secure advanced payments we have received from our customers. There were no borrowings under our revolving line of credit as of March 31, 2003 and 2002.

On November 27, 2002, we acquired a mortgage note payable with our acquisition of Paravant. The note is secured by the DRS Tactical Systems' facility located in Palm Bay, Florida, and bears interest at a rate equal to the one-month LIBOR plus 1.65%. Effective April 1, 2001, Paravant entered into a 15-year interest rate swap with an original notional amount of \$3.6 million to receive interest at a variable rate equal to the one-month LIBOR and to pay interest at a fixed rate of 7.85%. The balance of the mortgage as of

March 31, 2003 was \$3.3 million. Payment of principal and interest will continue through December 1, 2016.

On October 15, 2002, the Company issued an \$8.0 million promissory note, bearing interest at 6% per annum, related to the Nytech acquisition. Payments of \$5.0 million and \$3.0 million are due on the first and second anniversaries of the closing, respectively.

The aggregate maturities of long-term debt for fiscal 2004, 2005, 2006, 2007 and 2008 are \$7.7 million, \$5.5 million, \$2.4 million, \$2.3 million and \$102.7 million per year, respectively, and \$103.8 million thereafter.

We use "free cash flow" as a measure to evaluate our performance. The calculation of free cash flow is net cash provided by operating activities less capital expenditures. Free cash flow was \$30.5 million, \$14.3 million and \$18.1 million for fiscal 2003, 2002 and 2001, respectively (see Use of Non-GAAP Financial Measures below).

Contractual Obligations Our contractual obligations and commitments principally include obligations associated with our outstanding indebtedness and future minimum operating lease obligations as set forth in the table below:

(in thousands)	Payments Due by Period				
	Total	Less than 1 Year	1-3 Years	4-5 Years	More than 5 Years
Long-term debt obligations	\$224,554	\$ 7,717	\$ 7,952	\$105,049	\$103,836
Operating lease commitments	86,430	26,334	26,951	18,805	14,340
Acquisition earnouts (A)	38,500	9,750	27,950	800	—
Total contractual obligations	\$349,484	\$43,801	\$62,853	\$124,654	\$118,176

(A) Represents contingent purchase price payments or "earnouts" for certain of our acquisitions that are contingent upon the receipt of post-acquisition orders at those acquired businesses. Any amount that we pay for the earnouts will be reported as cash paid for acquisition of business within investing activities on the statement of cash flows and will be recorded as an increase to goodwill for the acquisition. The last earnout period expires on December 31, 2009.

We enter into standby letter-of-credit agreements with financial institutions and customers primarily relating to the guarantee of future performance on certain contracts to provide products and

services and to secure advance payments we have received from customers. At March 31, 2003, we had contingent liabilities on outstanding letters of credit as follows:

(in thousands)	Contingent Payments Due by Period			
	Total	Less than 1 Year	1-3 Years	More than 3 Years
Standby letters of credit	\$25,511	\$20,650	\$4,661	\$200

Backlog Funded backlog represents products or services that our customers have committed by contract to purchase from us. Due to the general nature of defense procurement and contracting, the operating cycle for our military business typically has been long term. Military backlog currently consists of various production and engineering development contracts with varying delivery schedules and project timetables. Our backlog also includes a significant amount of commercial off-the-shelf (COTS)-based systems for the military, which favor shorter delivery times. Accordingly, revenues for a particular year, or year-to-year comparisons of reported revenues and related backlog positions, may not be indicative of future results.

Backlog at March 31, 2003 was \$867.1 million, as compared with \$595.3 million at March 31, 2002. We booked \$723.5 million in new orders in fiscal 2003. The increase in backlog was due to the net effect of bookings and \$225.1 million of acquired backlog obtained through our fiscal 2003 acquisitions. Approximately 64% of backlog as of March 31, 2003 is expected to result in revenues during fiscal 2004.

ESG secured \$344.8 million in new contracts during fiscal 2003. Orders from the newly acquired DRS PCT contributed \$99.2 million. We received \$87.4 million of awards for the design and production of console and display systems, predominantly the AN/UYQ-70 Advanced Display Systems used in U.S. Navy surface ships, aircraft and submarines. Contract manufacturing and repair and technical services bookings accounted for \$38.8 million and \$11.8 million, respectively. ESG captured \$51.2 million of awards, including \$34.9 million from DRS Tactical Systems (formerly a Paravant operating unit), for rugged computers, servers and peripheral equipment used in intelligence applications, international battlefield digitization programs and rugged portable computers for the U.S. Army. Search and navigation system bookings accounted for \$31.8 million. DRS EPT and DRS PTI, both acquired in the fourth quarter, contributed \$2.4 million and \$4.9 million of bookings, respectively.

EOSG booked \$272.2 million during fiscal 2003. Key awards, primarily from the U.S. Army to provide sighting and targeting systems used in M2 Bradley Fighting Vehicles, M1 Abrams Battle Tanks, Javelin missile systems and Apache and Kiowa Warrior helicopters, were valued at \$192.0 million. Other awards totaling \$28.6 million were received for commercial laser vision correction systems and uncooled electro-optical technology. Infrared and electro-optical research technology development programs accounted for \$33.2 million in awards. Certain remote sensing products provided \$6.5 million in bookings.

FSCG received a total of \$105.4 million in new awards in fiscal 2003. Communications and surveillance systems provided \$43.5 million in bookings. Awards for high-speed cameras and flight and mission data recorders totaled \$33.6 million. Advanced electronic manufacturing services bookings for major aerospace prime contractors accounted for \$28.3 million.

DRS Ahead Technology, included in the operations of Other, booked \$1.2 million in new orders for magnetic burnish, glide and test verification heads used in the manufacture of computer disk drives.

Internal Research and Development In addition to customer-sponsored research and development, we also engage in internal research and development. These expenditures reflect our continued investment in new technology and diversification of our products. Expenditures for internal research and development in fiscal 2003, 2002 and 2001 were \$14.4 million, \$9.5 million and \$8.0 million, respectively.

Industry/Business Considerations We provide high-technology products and services to all branches of the U.S. military, major aerospace and defense prime contractors, government intelligence agencies, international military forces and industrial customers. We are a leading provider of thermal imaging devices, combat display workstations, electronic sensor systems, power systems, battlefield digitization systems, mission recorders and deployable flight incident recorders. Our products are deployed on a wide range of high-profile military platforms, such as DDG-51 Aegis destroyers, M1A2 Abrams Main Battle Tanks, M2A3 Bradley Fighting Vehicles, OH-58D Kiowa Warrior helicopters, AH-64 Apache helicopters, F/A-18E/F Super Hornet jet fighters and on several other platforms for military and non-military applications. Although we have diversified into commercial products and markets, the majority of our revenues are derived directly or indirectly from defense industry contracts with the U.S. government.

The landscape of the global defense industry continues to evolve as new events, such as those of September 11, 2001, demand alternative strategic defense initiatives. The defense requirements of the United States have shifted from defending against Cold War era threats to a focus upon the management of one or more regional conflicts, homeland security and proactive threat identification. For the first time in almost a decade, the U.S. defense procurement budget has increased, providing new funding for the acquisition and development of weapons and supporting systems. As a result of this change, the defense industry is now influenced by several key factors:

- New funding, which will assist in upgrading and replacing aging military systems and implementing new technologies to meet modern threats.

- Increased focus by the Department of Defense on “best value” instead of lowest cost. Best value procurement considers development and life-cycle costs in the evaluation of a system’s price.
- Consolidation within the industry. As a result of this consolidation, many domestic prime contractors are now focused on providing weapons platforms and systems integration, while relying on others to provide subsystems and components.
- The U.S. military is developing lighter, faster defense platforms that are able to react quickly to regional conflict. These highly mobile, rapidly deployable forces must rely on the latest technologies to provide a full awareness of the battlefield and its associated threats.

Despite an increased focus on new capabilities, traditional platforms remain important, as well. As many of these systems were neglected during years of reduced defense spending, the U.S. military is now faced with the need to refurbish these weapons platforms and upgrade their weapons systems with improved technology.

We are subject to certain inherent risks associated with defense contracting, including changes in government policies and dependence on Congressional support, primarily for appropriations and allocation of funds to products and programs that we support. In recent years, our products and programs have been well supported. However, uncertainty exists with respect to the size and scope of future defense budgets and their possible impact on existing or future products and programs. Further, our existing defense contracts are subject to termination, either at the convenience of the customer or as a result of cancellation of funding. Our contracts and operations also are subject to governmental oversight, particularly with respect to business practices, contract performance and cost accounting practices. Governmental investigations may lead to claims against us, the outcome of which cannot be predicted.

As described in Note 13 of Notes to Consolidated Financial Statements, in April and May 1998, subpoenas were issued to us by the United States Attorney for the Eastern District of New York seeking documents related to a governmental investigation of certain equipment manufactured by DRS Photronics, Inc. (DRS Photronics). These subpoenas were issued in connection with *United States v. Tress*, a criminal complaint against a then employee of our DRS Photronics operating unit, alleging that improper test data was provided in connection with boresighting equipment furnished to the U.S. Army. On June 26, 1998, the complaint against the employee was dismissed without prejudice. Additional subpoenas were issued to us on August 12, 1999 and May 10, 2000, relating to the ongoing investigation of DRS Photronics and one or more of its then employees. On May 17, 2002, DRS Photronics announced that it had entered into a global

settlement with the government, resolving all potential allegations related to the investigation. Under the terms of the settlement, DRS Photronics agreed to pay \$2.5 million in restitution and pleaded guilty to a violation of the False Claims Act.

We are party to various legal actions and claims arising in the ordinary course of our business. In our opinion, we have adequate legal defenses for each of the actions and claims, and we believe that their ultimate disposition will not have a material adverse effect on our consolidated financial position, results of operations or liquidity (see Note 13 of Notes to Consolidated Financial Statements).

The addition of international businesses involves additional risks, such as exposure to currency fluctuations and changes in foreign economic and political environments. International transactions frequently involve increased financial and legal risks arising from stringent contractual terms and conditions, and widely differing legal systems, customs and practices in foreign countries. We expect that international sales as a percentage of our overall sales will continue to increase in future years as a result of, among other factors, our growth strategy and continuing changes in the United States defense industry.

Our future operating results depend on our ability to successfully compete in a highly competitive industry that is characterized by rapid technology change and to effectively integrate acquired companies into our existing operations. Continuation of our recent revenue growth rate depends primarily on our ability to identify and acquire suitable acquisition targets. We have participated successfully in the defense industry consolidation through strategic business acquisitions and by streamlining our existing operations; however, we cannot guarantee that we will have sufficient funds available to us to continue investing in business acquisitions.

Use of Non-GAAP Financial Measures

Certain disclosures in this document include “non-GAAP (Generally Accepted Accounting Principles) financial measures.” A non-GAAP financial measure is defined as a numerical measure of a company’s financial performance that excludes or includes amounts so as to be different than the most directly comparable measure calculated and presented in accordance with GAAP in the Consolidated Statements of Earnings, Balance Sheets or Statements of Cash Flows of the Company. As required by the SEC’s recently issued Regulation G, a reconciliation of EBIT (earnings before interest and taxes), EBITDA (earnings before interest, taxes, depreciation and amortization) and “free cash flow” with the most directly comparable GAAP measure follows:

EBIT and EBITDA

We define EBIT as earnings from continuing operations before extraordinary items, net interest and related expenses (primarily amortization of debt issuance costs), and income taxes, and EBITDA as earnings from continuing operations before extraordinary items, net interest and related expenses (primarily

amortization of debt issuance costs), income taxes, and depreciation and amortization. We believe that the most directly comparable GAAP financial measure to EBIT and EBITDA is net cash from operating activities of continuing operations. The table below presents net cash flows from operating activities of continuing operations and also presents a reconciliation of earnings from continuing operations before extraordinary item.

(in thousands)	Year Ended March 31,				
	2003	2002	2001	2000	1999
Net cash flows from operating activities of continuing operations	\$52,008	\$27,849	\$34,270	\$ 8,017	\$15,558
Earnings from continuing operations before extraordinary item	\$30,171	\$20,331	\$11,978	\$ 7,661	\$ 3,865
Income taxes	25,701	18,030	12,976	5,171	1,915
Interest income	(1,179)	(1,144)	(202)	(200)	(350)
Interest and related expenses	10,589	10,954	11,461	12,600	9,357
EBIT	65,282	48,171	36,213	25,232	14,787
Depreciation and amortization	16,660	13,789	16,125	17,070	11,601
EBITDA	\$81,942	\$61,960	\$52,338	\$42,302	\$26,388

EBIT and EBITDA are presented as additional information because we believe they are useful indicators of an entity's debt capacity and its ability to service its debt. EBIT and EBITDA are not a substitute for operating income, net earnings or cash flows from operating activities, as determined in accordance with generally accepted accounting principles. EBIT and EBITDA are not complete net cash flow measures because they are financial performance measures that do not include reductions for cash payments for an entity's obligation to service its debt, fund its working capital and capital expenditures, and pay its income taxes. EBIT is not a complete measure of an entity's profitability

because it does not include costs and expenses for interest and income taxes, and EBITDA is not a complete measure of an entity's profitability because it does not include costs and expenses for interest and income taxes, and depreciation and amortization. Rather, EBIT and EBITDA are potential indicators of an entity's ability to fund these cash requirements. EBIT and EBITDA, as we define them, may differ from similarly named measures used by other entities and, consequently, could be misleading unless all entities calculate and define EBIT and EBITDA in the same manner.

Free Cash Flow

We define free cash flow as net cash from operating activities of continuing operations less capital expenditures. We believe

that the most directly comparable GAAP financial measure to free cash flow is net cash from operating activities. The table below presents a reconciliation of cash flows from operating activities to free cash flow.

(in thousands)	Year Ended March 31,				
	2003	2002	2001	2000	1999
Net cash flows from operating activities of continuing operations	\$52,008	\$27,849	\$34,270	\$8,017	\$15,558
Capital expenditures	(21,526)	(13,583)	(16,185)	(6,210)	(6,554)
Free cash flow	\$30,482	\$14,266	\$18,085	\$1,807	\$ 9,004

We disclose free cash flow because we believe that it is a measurement of cash flow generated that is available to common stockholders. Free cash flow represents cash generated after paying for interest on borrowings, income taxes, capital expenditures and changes in working capital, but before repaying outstanding debt and investing cash to acquire businesses and making other strategic investments. Thus, key assumptions underlying free cash flow are that we will be able to refinance our

existing debt when it matures with new debt, and that we will be able to finance any new acquisitions we make by raising new debt or equity capital.

Net Debt

The table below presents a reconciliation of total outstanding debt to net debt.

(in thousands)	March 31,				
	2003	2002	2001	2000	1999
Current installments of long-term debt	\$ 7,717	\$ 1,435	\$ 7,217	\$ 5,699	\$ 5,844
Short-term bank debt	521	226	831	17,781	9,169
Long-term debt, excluding current installments	216,837	138,060	75,076	97,695	102,091
Cash and cash equivalents	(95,938)	(117,782)	(2,324)	(3,778)	(10,031)
Net debt	\$129,137	\$ 21,939	\$80,800	\$117,397	\$107,073

Recently Issued Accounting Pronouncements

In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations" (SFAS 143). SFAS 143 applies to legal obligations associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development or normal operation of a long-lived asset, except for certain obligations of lessees. This statement does not apply to obligations that arise solely from a plan to dispose of a long-lived asset. SFAS 143 requires that estimated asset retirement costs be measured at their fair values and recognized as assets and depreciated over the useful life of the related asset. Similarly, liabilities for the present value of asset retirement obligations are to be recognized and accreted each year to their estimated future value until the asset is retired. These provisions will be applied to existing asset retirement obligations, as of the adoption date, as a

cumulative effect of a change in accounting policy. SFAS 143 is effective for us beginning April 1, 2003. SFAS 143 is not expected to have a material effect on our consolidated results of operations and financial position.

In November 2002, the FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN 45). FIN 45 requires that a liability be recorded in the guarantor's balance sheet upon issuance or modification of a guarantee. In addition, FIN 45 requires disclosures about the guarantees that an entity has issued, including a roll forward of the entity's product warranty liabilities. We have adopted the provisions of FIN 45 and have included the required disclosures in Note 1 of Notes to Consolidated Financial Statements. FIN 45 is not expected to have a material effect on our consolidated results of operations and financial position.

Consolidated Balance Sheets

DRS Technologies, Inc. and Subsidiaries

(in thousands, except share data)	March 31,	
	2003	2002
Assets		
Current assets		
Cash and cash equivalents	\$ 95,938	\$117,782
Accounts receivable, net	163,048	110,861
Inventories, net	114,102	120,910
Prepaid expenses, deferred income taxes and other current assets	16,211	9,276
Total current assets	389,299	358,829
Property, plant and equipment, net	87,610	50,481
Acquired intangible assets, net	44,781	34,133
Goodwill	436,863	142,610
Deferred income taxes and other noncurrent assets	13,568	15,038
Total assets	\$972,121	\$601,091
Liabilities and Stockholders' Equity		
Current liabilities		
Current installments of long-term debt	\$ 7,717	\$ 1,435
Short-term bank debt	521	226
Accounts payable	68,340	49,671
Accrued expenses and other current liabilities	212,697	142,260
Total current liabilities	289,275	193,592
Long-term debt, excluding current installments	216,837	138,060
Other liabilities	27,829	12,204
Total liabilities	533,941	343,856
Commitments and contingencies (Notes 8 and 13)		
Stockholders' equity		
Preferred stock, no par value. Authorized 2,000,000 shares; none issued at March 31, 2003 and 2002	—	—
Common stock, \$.01 par value per share. Authorized 30,000,000 shares; issued 22,421,986 shares and 16,834,052 shares at March 31, 2003 and 2002, respectively	224	168
Additional paid-in capital	343,605	197,387
Retained earnings	94,527	64,356
Accumulated other comprehensive losses	(176)	(4,630)
Unamortized stock compensation	—	(46)
Total stockholders' equity	438,180	257,235
Total liabilities and stockholders' equity	\$972,121	\$601,091

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Earnings

DRS Technologies, Inc. and Subsidiaries

(in thousands, except per-share data)	Year ended March 31,		
	2003	2002	2001
Revenues	\$675,762	\$517,200	\$427,606
Costs and expenses	608,078	467,431	390,075
Operating income	67,684	49,769	37,531
Interest income	1,179	1,144	202
Interest and related expenses	10,589	10,954	11,461
Other (expense) income, net	(824)	8	108
Earnings before minority interests and income taxes	57,450	39,967	26,380
Minority interests	1,578	1,606	1,426
Earnings before income taxes	55,872	38,361	24,954
Income taxes	25,701	18,030	12,976
Net earnings	\$ 30,171	\$ 20,331	\$ 11,978
Net earnings per share of common stock:			
Basic earnings per share	\$ 1.64	\$ 1.52	\$ 1.14
Diluted earnings per share	\$ 1.58	\$ 1.41	\$ 1.01

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Stockholders' Equity and Comprehensive Earnings

DRS Technologies, Inc. and Subsidiaries

(in thousands, except share data)	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Losses	Treasury Stock		Unamortized Stock Compensation	Total Stockholders' Equity
	Shares	Amount				Shares	Amount		
Balances at March 31, 2000	9,717,020	\$ 97	\$ 48,584	\$ 32,047	\$ (86)	440,939	\$(1,988)	\$(470)	\$ 78,184
Comprehensive earnings:									
Net earnings	—	—	—	11,978	—	—	—	—	11,978
Foreign currency translation adjustments	—	—	—	—	(3,882)	—	—	—	(3,882)
Total comprehensive earnings									8,096
Stock options and warrants exercised	248,391	2	2,289	—	—	—	—	—	2,291
Income tax benefit from stock options exercised	—	—	607	—	—	—	—	—	607
Compensation relating to stock options and other stock awards, net of forfeitures	(10,465)	—	(105)	—	—	—	—	206	101
Conversion of 9% debentures	2,188,691	22	18,645	—	—	—	—	—	18,667
Equity issued in connection with GAC acquisition	355,359	4	3,997	—	—	—	—	—	4,001
Cancellation of treasury stock	(440,939)	(4)	(1,984)	—	—	(440,939)	1,988	—	—
Balances at March 31, 2001	12,058,057	121	72,033	44,025	(3,968)	—	—	(264)	111,947
Comprehensive earnings:									
Net earnings	—	—	—	20,331	—	—	—	—	20,331
Unrealized losses on hedging instruments:									
Cumulative adjustment at April 1, 2001, net of income taxes	—	—	—	—	(289)	—	—	—	(289)
Unrealized losses on hedging instruments, net of income taxes	—	—	—	—	(198)	—	—	—	(198)
Foreign currency translation adjustments	—	—	—	—	(175)	—	—	—	(175)
Total comprehensive earnings									19,669
Stock options exercised	454,317	4	3,780	—	—	—	—	—	3,784
Income tax benefit from stock options exercised	—	—	3,420	—	—	—	—	—	3,420
Compensation relating to stock options	—	—	—	—	—	—	—	218	218
Secondary stock issuance	3,755,000	37	112,557	—	—	—	—	—	112,594
Warrants exercised	580,906	6	5,803	—	—	—	—	—	5,809
Other	(14,228)	—	(206)	—	—	—	—	—	(206)
Balances at March 31, 2002	16,834,052	168	197,387	64,356	(4,630)	—	—	(46)	257,235
Comprehensive earnings:									
Net earnings	—	—	—	30,171	—	—	—	—	30,171
Unrealized losses on hedging instruments, net of income taxes	—	—	—	—	(70)	—	—	—	(70)
Foreign currency translation adjustments	—	—	—	—	4,524	—	—	—	4,524
Total comprehensive earnings									34,625
Stock options exercised	125,434	1	1,121	—	—	—	—	—	1,122
Income tax benefit from stock options exercised	—	—	808	—	—	—	—	—	808
Compensation relating to stock options	—	—	—	—	—	—	—	46	46
Secondary stock issuance	5,462,500	55	144,289	—	—	—	—	—	144,344
Balances at March 31, 2003	22,421,986	\$224	\$343,605	\$94,527	\$(176)	—	\$ —	\$ —	\$438,180

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows

DRS Technologies, Inc. and Subsidiaries

(in thousands)	Year Ended March 31,		
	2003	2002	2001
Cash Flows from Operating Activities			
Net earnings	\$30,171	\$ 20,331	\$11,978
Adjustments to reconcile net earnings to cash flows from operating activities:			
Depreciation and amortization	16,660	13,789	16,125
Deferred income taxes	6,919	2,895	(287)
Inventory reserves and provision for doubtful accounts	2,063	(542)	2,654
Loss on sale of operating unit	575	—	—
Other, net	743	788	1,856
Changes in assets and liabilities, net of effects from business combinations and divestitures:			
Increase in accounts receivable	(22,588)	(2,618)	(15,926)
Decrease (increase) in inventories	9,249	(25,400)	(10,007)
(Increase) decrease in prepaid expenses and other current assets	(2,983)	(3,424)	354
Increase in accounts payable	15,121	9,546	11,007
(Decrease) increase in accrued expenses and other current liabilities	(33,817)	6,835	7,311
Increase in customer advances	20,516	4,573	7,057
Other, net	9,379	1,076	2,148
Net cash provided by operating activities	52,008	27,849	34,270
Cash Flows from Investing Activities			
Capital expenditures	(21,526)	(13,583)	(16,185)
Payments pursuant to business combinations, net of cash acquired	(265,058)	(71,606)	(7,374)
Proceeds from sales of businesses	7,624	—	3,000
Other, net	239	246	904
Net cash used in investing activities	(278,721)	(84,943)	(19,655)
Cash Flows from Financing Activities			
Net borrowings (payments) of short-term debt	272	(599)	(2,628)
Borrowings of long-term debt	81,478	218,250	44,784
Debt issuance costs	(2,254)	(5,974)	—
Net payments on long-term debt	(8,459)	(161,093)	(60,502)
Retirement of long-term debt	(12,195)	—	—
Proceeds from sale of common stock	144,344	112,594	—
Proceeds from exercise of stock options and warrants	1,122	9,589	2,188
Other, net	90	(202)	102
Net cash provided by (used in) financing activities	204,398	172,565	(16,056)
Effect of exchange rates on cash and cash equivalents	471	(13)	(13)
Net (decrease) increase in cash and cash equivalents	(21,844)	115,458	(1,454)
Cash and cash equivalents, beginning of year	117,782	2,324	3,778
Cash and cash equivalents, end of year	\$95,938	\$117,782	\$ 2,324

See accompanying Notes to Consolidated Financial Statements.

1. Summary of Significant Accounting Policies

A. Organization DRS Technologies, Inc. and subsidiaries (hereinafter, DRS or the Company) is a supplier of defense electronic products and systems. The Company provides high-technology products and services to all branches of the U.S. military, major aerospace and defense prime contractors, government intelligence agencies, international military forces and industrial markets. Incorporated in 1968, DRS has served the defense industry for 34 years. DRS is a provider of thermal imaging devices, combat display workstations, electronic sensor systems, power systems, battlefield digitization systems, mission recorders and deployable flight incident recorders. The Company's products are deployed on a wide range of military platforms, such as DDG-51 Aegis destroyers, M1A2 Abrams Main Battle Tanks, M2A3 Bradley Fighting Vehicles, OH-58D Kiowa Warrior helicopters, AH-64 Apache helicopters, F/A-18E/F Super Hornet jet fighters and on several other platforms for military and non-military applications.

B. Basis of Presentation and Use of Estimates The consolidated financial statements include the accounts of DRS Technologies, Inc., its subsidiaries (all of which are wholly owned) and a partnership of which DRS owns an 80% controlling interest. All significant inter-company transactions and balances have been eliminated in consolidation.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant of these estimates and assumptions relate to the recognition of contract revenues and estimated costs to complete contracts in process, market values of inventories reported at lower of cost or market, recoverability of reported amounts of fixed assets, goodwill and intangible assets, and valuation of deferred tax assets and liabilities. Actual results could differ from these estimates.

C. Classifications Unbilled receivables, inventories, accrual for future costs on uncompleted contracts and accrual for future costs related to acquired contracts are primarily attributable to long-term contracts or programs in progress for which the related operating cycles are longer than one year. In accordance with industry practice, these items are included in current assets and liabilities, respectively. It is the Company's policy to classify any outstanding revolving line of credit borrowings as long-term debt, excluding current installments to reflect the intent of the borrowings and their maturity date, which as of March 31, 2003

and 2002, was greater than one year. As of March 31, 2003 and 2002, there were no borrowings outstanding under the Company's revolving line of credit.

Certain other amounts for prior years have been reclassified to conform with the fiscal 2003 presentation.

D. Translation of Foreign Currency Financial Statements and Foreign Currency Transactions Transactions in foreign currencies are translated into U.S. dollars at the approximate prevailing rate at the time of the transaction. The operations of the Company's foreign subsidiaries are translated from the local (functional) currencies into U.S. dollars. The rates of exchange at each balance sheet date are used for translating certain balance sheet accounts, and a weighted average rate of exchange is used for translating the statements of earnings. Gains or losses resulting from these translation adjustments are included in the accompanying Consolidated Balance Sheets as a component of accumulated other comprehensive losses. Foreign exchange transaction gains and losses in fiscal 2003, 2002 and 2001 were immaterial to the Company's overall results of operations.

E. Cash and Cash Equivalents The Company considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents.

F. Receivables Receivables consist of amounts billed and currently due from customers, and unbilled costs and accrued profits primarily related to revenues on long-term contracts that have been recognized for accounting purposes, but not yet billed to customers.

G. Inventories Commercial and other non-contract inventories are stated at the lower of cost (which includes material, labor and manufacturing overhead) or net realizable value. Costs accumulated under contracts are stated at actual cost, not in excess of estimated net realizable value, including, for long-term government contracts, applicable amounts of general and administrative expenses, which include internal research and development costs and bid and proposal costs, where such costs are recoverable under customer contracts. General and administrative expenses related to commercial products and services provided essentially under commercial terms and conditions are expensed as incurred and are included in costs and expenses in the Consolidated Statements of Earnings.

Pursuant to contract provisions, agencies of the U.S. government and certain other customers have title to, or a security interest in, inventories related to such contracts as a result of progress payments and advances. Accordingly, such progress payments and certain advances are reflected as an offset against the related inventory balances. To the extent that customer advances exceed related inventory levels, such advances are classified as current liabilities.

H. Property, Plant and Equipment Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation and amortization are calculated on the straight-line method. The ranges of estimated useful lives are: office furnishings, laboratory, production, computer and other equipment, 3-10 years; building and building improvements, 15-40 years; and leasehold improvements, over the shorter of the estimated useful lives of the improvements or the life of the lease. When property, plant and equipment is retired or otherwise disposed of, the net book value of the asset is removed from the Company's balance sheet and the net gain or loss is included in the determination of income. Maintenance and repairs are charged to operations as incurred; renewals and betterments are capitalized.

I. Debt Issuance Costs Costs incurred to issue debt are deferred and amortized as interest expense over the term of the related debt using a method that approximates the effective interest method.

J. Goodwill and Acquired Intangible Assets In July 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141 and No. 142, "Business Combinations" and "Goodwill and Other Intangible Assets" (SFAS 141 and SFAS 142), respectively. SFAS 141 replaces Accounting Principles Board (APB) Opinion No. 16 and requires the use of the purchase method for all business combinations initiated after June 30, 2001. It also provides guidance on purchase accounting related to the recognition of intangible assets, noting that any purchase price allocated to an assembled workforce may not be accounted for separately, and accounting for negative goodwill. SFAS 142 requires that goodwill and identifiable acquired intangible assets with indefinite useful lives shall no longer be amortized, but tested for impairment annually and whenever events or circumstances occur indicating that goodwill or indefinite life intangibles might be impaired. SFAS 142 also requires the amortization of identifiable intangible assets with finite useful lives, although the Statement no longer limits the amortization period to forty years. Identifiable acquired intangible assets, which are subject to amortization, are to be tested for impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets."

The Company elected to adopt the provisions of SFAS 142 as of April 1, 2001. Upon adoption of SFAS 142, amortization of goodwill recorded for business combinations ceased, and intangible assets that did not meet the criteria for recognition apart from goodwill under SFAS 141 were reclassified to goodwill. In connection with the adoption of SFAS 142, the Company was required to perform a transitional goodwill impairment assessment within six months of adoption. The Company completed its transitional goodwill impairment assessment, with no adjustment

to the carrying value of its goodwill as of April 1, 2001.

The annual impairment test is performed after completion of the Company's annual financial operating plan, which occurs in the fourth quarter of its fiscal year. The Company completed its annual impairment tests with no adjustment to the carrying value of its goodwill as of March 31, 2003 and 2002. The annual goodwill impairment assessment involves estimating the fair values of the Company's four reporting units (three reporting units in fiscal 2002) and comparing such fair values with the reporting unit's respective carrying amount. If the carrying value of the reporting unit exceeds its fair value, additional steps are followed to recognize a potential impairment loss. Calculating the fair value of the reporting units requires significant estimates and assumptions by management. The Company estimates the fair value of its reporting units by applying third party market value indicators to the reporting unit's projected revenues, earnings before net interest and taxes (EBIT) and earnings before net interest, taxes, depreciation and amortization (EBITDA), and calculating an average of the three extended values.

The Company is amortizing its acquired intangibles on a straight-line basis over 4-30 years. See Note 3 below for additional information on goodwill and acquired intangible assets.

K. Impairment of Long-Lived Assets and Acquired Intangible Assets The Company assesses the recoverability of the carrying value of its long-lived assets and identifiable acquired intangible assets with finite useful lives held for use, whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. The Company evaluates the recoverability of such assets based upon the expectations of undiscounted cash flows from such assets. If the sum of the expected future undiscounted net cash flows is less than the carrying amount of the asset, a loss would be recognized for the difference between the fair value and the carrying amount of the asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value, less the costs to sell.

L. Derivative Financial Instruments DRS does not use derivative financial instruments for trading purposes. The Company utilizes variable rate debt to fund its operations and sustain its growth. Such variable rate borrowings expose the Company to interest rate risk and the related impact that changes in interest rates can have on the Company's earnings and on its cash flows. In an effort to limit its interest expense and cash flow exposure, the Company may from time to time enter into various derivative instruments that meet the criteria to be accounted for as hedges. The Company does not enter into derivatives designated as fair value hedges.

Effective April 1, 2001, the Company adopted SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities," as amended (SFAS 133). This Statement requires the recognition of

all derivative instruments as either assets or liabilities in the consolidated balance sheets and the periodic adjustment of those instruments to fair value. The classification of gains and losses resulting from changes in the fair values of derivatives is dependent on the intended use of the derivative and its resultant designation.

On the date a derivative contract is entered into, the Company designates the hedging relationship. The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy. This process includes linking all derivatives that are designated as hedges to specific assets or liabilities on the balance sheet or to forecasted transactions. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of the hedged items. Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a cash flow hedge are recorded in accumulated other comprehensive losses until operations are affected by the variability in cash flows of the designated item. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, the Company discontinues hedge accounting prospectively, as discussed below.

The Company discontinues hedge accounting prospectively when: (1) it is determined that a derivative is no longer effective in offsetting changes in the cash flows of a hedged item; (2) the derivative expires or is sold, terminated or exercised; or (3) the derivative is discontinued as a hedging instrument, because it is unlikely that a forecasted transaction will occur. When hedge accounting is discontinued because it is determined that the derivative no longer qualifies as an effective hedge of cash flows, the derivative will continue to be carried at fair value in the Consolidated Balance Sheets, and gains and losses that were accumulated in other comprehensive income are recognized immediately in earnings.

On April 1, 2001, in accordance with the provisions of SFAS 133, the Company designated its previously outstanding interest rate collars as cash flow hedges and recorded the fair value of the instruments on the balance sheet at that date, with a corresponding adjustment to accumulated other comprehensive losses. Due to the nature and characteristics of the Company's collars, all adjustments to the fair values of such instruments were adjusted via accumulated other comprehensive losses. In accordance with certain covenants in DRS's previous credit facility, the Company entered into interest rate collar agreements, none of which were in place as of March 31, 2003, with notional amounts covering a limited amount of the aggregate outstanding principal balance of the Company's term loans (see Note 8 below). An interest rate collar is a combination of an interest rate cap and an interest rate floor. The collars allowed the Company to manage a portion of its variable rate borrowings within an acceptable,

predetermined range. Under the collar, no payments were required to be made by the Company or paid to the Company unless the prevailing LIBOR rate (London Interbank Offered Rate) dropped below the floor or exceeded the ceiling. Any payments made or received by the Company while the collars were in effect were reflected as an adjustment to interest expense in the period in which it was settled.

In connection with the November 27, 2002 acquisition of Paravant Inc. (see Note 2), the Company acquired a mortgage note payable with a variable interest rate equal to one month LIBOR plus 1.65% and a 15-year interest rate swap with a notional amount of \$3.6 million. Under the terms of the interest rate swap, the Company receives interest at a variable rate equal to LIBOR and pays interest at a fixed rate of 7.85%. The combination of the swap and the debt obligation results in a net cash outflow equal to 9.5%. Repricing dates of the swap match those of the mortgage note. The fixed rate of 9.5% will remain the same until the swap expires on April 1, 2016. The Company has evaluated the terms and conditions of the swap and determined the instrument qualifies as a cash flow hedge pursuant to SFAS 133. Accordingly, adjustments to the fair value of the swap are included in other accumulated comprehensive losses.

The effect of adopting SFAS 133 at April 1, 2001 and the amounts recorded related to its derivative financial instruments, as of and for the years ended March 31, 2003 and 2002, were immaterial to the Company's consolidated financial position, consolidated results of operations and cash flows.

M. Revenue Recognition The substantial majority of the Company's direct and indirect sales to the U.S. government and certain of the Company's sales to foreign governments and commercial customers are made pursuant to written contractual arrangements or "contracts" to design, develop, manufacture and/or modify complex products to the specifications of the buyers (customers), or to provide services related to the performance of such contracts. These contracts are accounted for in accordance with American Institute of Certified Public Accountants Statement of Position 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts" (SOP 81-1), and revenues and profits are recognized using percentage-of-completion methods of accounting. Revenues and profits on fixed-price production contracts whose units are produced and delivered in a continuous or sequential process are recorded as units are delivered based on their selling prices (the "units-of-delivery" method). In certain limited circumstances, when all applicable revenue recognition criteria are met, revenue may be recognized prior to shipment to the customer, as discussed below. Revenues and profits on other fixed-price contracts with significant engineering as well as production requirements are recorded based on the ratio of total actual incurred costs to date to the total estimated costs for each contract (the "cost-to-cost" method).

Revenue recognition on cost-reimbursable contracts with the U.S. government are accounted for in accordance with Accounting Research Bulletin No. 43, Chapter 11, Section A, Government Contracts, Cost-Plus-Fixed Fee Contracts (ARB 43), in addition to SOP 81-1. Revenues and profits on cost-reimbursable contracts are recognized as allowable costs are incurred on the contract and become billable to the customer, in an amount equal to the allowable costs plus the profit on those costs, which is generally fixed or variable based on the contract fee arrangement.

Revenues on arrangements that are not within the scope of SOP 81-1 or ARB 43 are recognized in accordance with the Security and Exchange Commission's Staff Accounting Bulletin No. 101. Revenues are recognized when there is persuasive evidence of an arrangement, delivery has occurred or services have been performed, the selling price to the buyer is fixed or determinable and collectibility is reasonably assured.

Most of the Company's contracts are long-term in nature, spanning multiple years. The Company reviews cost performance and estimates to complete on its ongoing and acquired contracts at least quarterly and in many cases more frequently. The impact of revisions in profit estimates on both fixed-price and cost-reimbursable contracts is recognized on a cumulative catch-up basis in the period in which the revisions are made. Provisions for anticipated losses on contracts are recorded in the period in which they become evident.

Amounts representing contract change orders, claims or other items are included in revenues only when they can be reliably estimated and realization is probable, and are determined on a percentage-of-completion basis measured by the cost-to-cost method. Incentives or penalties and awards applicable to performance on contracts are considered in estimating revenues and profit rates, and are recorded when there is sufficient information to assess anticipated contract performance. Incentive provisions, which increase or decrease earnings based solely on a single significant event, are not recognized until the event occurs.

The Company records contract-related assets and liabilities acquired in business combinations at their fair value by considering the remaining contract amounts to be billed, DRS's estimate to complete and a reasonable profit allowance on the Company's completion effort commensurate with the profit margin that the Company earns on similar contracts. Revisions to cost estimates subsequent to the date of acquisition may be recorded as an adjustment to goodwill or earnings, depending on the nature and timing of the revision.

Included in revenues for fiscal 2003, 2002 and 2001 were \$43.8 million, \$36.2 million and \$32.9 million, respectively, of customer-sponsored research and development, which are principally accounted for under the cost reimbursement method.

Approximately 81%, 78% and 78% of the revenues in fiscal 2003, 2002 and 2001, respectively, were derived directly or

indirectly from defense-related contracts with the United States government. In addition, approximately 9% in fiscal 2003, 11% in fiscal 2002 and 12% in fiscal 2001 of the Company's revenues were derived directly or indirectly from sales to international governments.

N. Stock-Based Compensation At March 31, 2003, the Company had one stock-based compensation plan, which is described more fully in Note 11. The Company accounts for the plan under the recognition and measurement principles of APB Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations. The following table illustrates the effect on net earnings and earnings per share as if the Company had applied the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," to stock-based employee compensation.

(in thousands, except per-share data)	Year Ended March 31,		
	2003	2002	2001
Net earnings, as reported	\$30,171	\$20,331	\$11,978
Add: Stock-based compensation expense included in reported net earnings, net of related tax effects	46	218	206
Less: Total stock-based compensation expense determined under fair value-based method for all awards, net of related tax effects	(2,351)	(1,250)	(597)
Pro forma net earnings	\$27,866	\$19,299	\$11,587
Earnings per share:			
Basic – as reported	\$ 1.64	\$ 1.52	\$ 1.14
Basic – pro forma	\$ 1.51	\$ 1.44	\$ 1.11
Diluted – as reported	\$ 1.58	\$ 1.41	\$ 1.01
Diluted – pro forma	\$ 1.46	\$ 1.34	\$ 0.93

For purposes of determining the pro forma effects of SFAS 123, the estimated fair value of options granted was calculated using the Black-Scholes option pricing valuation model. The weighted-average assumptions used in the valuation model are presented in the table below.

	Year Ended March 31,		
	2003	2002	2001
Expected holding period (in years)	5.0	5.0	5.0
Expected volatility	46.1%	44.2%	28.9%
Expected dividend yield	—	—	—
Risk-free interest rate	3.0%	4.5%	5.7%
Weighted-average fair value of options granted	\$14.11	\$11.90	\$4.85

O. Income Taxes In accordance with SFAS No. 109, "Accounting for Income Taxes" (SFAS 109), the Company recognizes deferred tax assets and liabilities for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. A valuation allowance is provided when it is more likely than not that some portion or all of a deferred tax asset will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the period in which related temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in earnings in the period that includes the enactment date.

P. Earnings per Share Basic earnings per share (EPS) is computed by dividing net earnings by the weighted average number of shares of common stock outstanding during each period. The computation of diluted earnings per share includes the effect of shares from the assumed exercise of dilutive stock options and warrants and, when dilutive, the effect of the assumed conversion of the Company's previously outstanding 9% Senior Subordinated Debentures. The following table provides the components of the earnings per-share computations:

(in thousands, except per-share data)	Year Ended March 31,		
	2003	2002	2001
Basic EPS Computation			
Net earnings	\$30,171	\$20,331	\$11,978
Weighted average			
common shares outstanding	18,411	13,408	10,485
Basic earnings per share	\$ 1.64	\$ 1.52	\$ 1.14
Diluted EPS Computation			
Net earnings	\$30,171	\$20,331	\$11,978
Interest and expenses			
related to convertible debentures	—	—	574
Adjusted net earnings	\$30,171	\$20,331	\$12,552
Diluted common shares outstanding:			
Weighted average			
common shares outstanding	18,411	13,408	10,485
Stock options and warrants	662	1,047	642
Convertible debentures	—	—	1,308
Diluted common shares outstanding	19,073	14,455	12,435
Diluted earnings per share	\$ 1.58	\$ 1.41	\$ 1.01

Q. Fair Value of Financial Instruments Cash and cash equivalents, accounts receivable, accounts payable, accrued expenses and other current liabilities and derivative instruments reported in the Consolidated Balance Sheets equal or approximate their fair values. The fair value of the Company's outstanding term loan approximates its recorded value, based on the variable rates of the facility and currently available terms and conditions for similar debt at March 31, 2003.

R. Product Warranties Product warranty costs are accrued when the covered products are delivered to the customer. Product warranty expense is recognized based on the terms of the product warranty and the related estimated costs, considering historical claims expense. Accrued warranty costs are reduced as these costs are incurred and as the warranty period expires. The table below presents the changes in the Company's accrual for product warranties, which is included in accrued expenses, for the year ended March 31, 2003.

(in thousands)	
Balance at April 1, 2002	\$10,319
Acquisitions during fiscal 2003	9,017
Accruals for product warranties issued during fiscal 2003	5,399
Accruals related to pre-existing product warranties	75
Settlements made during the period	(5,445)
Balance at March 31, 2003	\$19,365

S. New Accounting Pronouncements In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations" (SFAS 143). SFAS 143 applies to legal obligations associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development or normal operation of a long-lived asset, except for certain obligations of lessees. This Statement does not apply to obligations that arise solely from a plan to dispose of a long-lived asset. SFAS 143 requires that estimated asset retirement costs be measured at their fair values, and recognized as assets and depreciated over the useful life of the related asset. Similarly, liabilities for the present value of asset retirement obligations are to be recognized and accreted each year to their estimated future value until the asset is retired. These provisions will be applied to existing asset retirement obligations, as of the adoption date, as a cumulative effect of a change in accounting policy. SFAS 143 is effective for the Company beginning April 1, 2003. SFAS 143 is not expected to have a material effect on the Company's consolidated results of operations and financial position.

In November 2002, the FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN 45). FIN 45 requires that a liability be recorded in the guarantor's balance sheet upon issuance or modification of a

guarantee. In addition, FIN 45 requires disclosures about the guarantees that an entity has issued, including a rollforward of the entity's product warranty liabilities. The Company has adopted the provisions of FIN 45 and has included the required disclosures in "R. Product Warranties" above. FIN 45 is not expected to have a material effect on the Company's consolidated results of operations and financial position.

2. Acquisitions and Divestitures

Acquisitions

On February 14, 2003, the Company acquired all of the outstanding stock of Power Technology Incorporated, a privately held company principally located in Fitchburg, Massachusetts, for \$35.0 million in cash, subject to adjustment, plus \$14.0 million of contingent consideration. Contingent consideration is based on earnout payments, as defined in the purchase agreement, that are triggered by the receipt of certain funded booking awards on or before certain dates (earnout dates), the last of which expires on or before December 31, 2008. If the Company does not receive these funded backlog awards on or before these earnout dates, it will have no liability nor obligation to pay any contingent consideration. The earnout period began on the closing date of the acquisition. Renamed DRS Power Technology, Inc. (DRS PTI), the company operates as part of DRS's Electronic Systems Group (ESG). In addition to the purchase price, the estimated costs related to the acquisition, including professional fees, approximated \$1.5 million. DRS PTI designs, develops, manufactures and provides life-cycle support for a wide variety of high-performance, complex power systems and rotating machinery, and is concentrated in four major areas: Navy Electric Drive Equipment, Navy Main Propulsion Turbines, High-Performance Navy Pumps, and Fuel Cells and Industrial Equipment. The addition of DRS PTI to DRS's existing power systems product lines is a significant part of the Company's strategy of providing Naval vessels with a totally integrated gas turbine or steam turbine propulsion plant, either electric or mechanical drive, and is expected to enhance DRS's ability to expand onto other electric drive platforms supporting Navy growth initiatives.

The Company is in the process of obtaining third-party valuations of certain assets acquired, as well as performing its own internal assessment of the acquired contracts; thus, the preliminary allocation of the purchase price may change. Based on preliminary purchase price allocations, the Company has estimated goodwill to be \$35.6 million and has allocated the estimated goodwill to ESG. The Company expects to complete the purchase price allocation in the first quarter of fiscal 2004.

On January 15, 2003, the Company acquired the assets and certain liabilities of the Electromagnetics Development Center of Kaman Aerospace, a subsidiary of Kaman Corporation, located in Hudson, Massachusetts, for \$27.5 million in cash, subject to adjustment, plus \$7.5 million of contingent consideration.

Contingent consideration is based on a funded booking milestone, as defined in the purchase agreement. If the funded booking milestone is not fulfilled on or before December 31, 2008, DRS will have no liability or obligation to pay any contingent consideration. The earnout period began on the closing date of the acquisition. In addition to the purchase price, the estimated costs related to the acquisition, including professional fees, approximated \$1.2 million. Kaman's Electromagnetics Development Center develops high-performance, lightweight electric motors, generators and drive electronics for defense, industrial and transportation applications. Renamed DRS Electric Power Technologies, Inc. (DRS EPT), the company operates as part of ESG. The addition of DRS EPT is complementary to DRS's existing position in ship electric propulsion equipment, control equipment, high-performance networks, tactical displays and specialty reactor plant instrumentation.

The Company is in the process of obtaining third-party valuations of certain assets acquired, as well as performing its own internal assessment of the acquired contracts; thus, the preliminary allocation of the purchase price may change. Based on preliminary purchase price allocations, the Company has estimated goodwill to be \$20.9 million and has allocated the estimated goodwill to ESG. The Company expects to complete the purchase price allocation in the first quarter of fiscal 2004.

On November 27, 2002, a wholly-owned subsidiary of the Company merged with and into Paravant Inc. (Paravant), with Paravant being the surviving corporation and continuing as a wholly-owned subsidiary of DRS. Consideration in the Paravant acquisition was \$94.7 million in cash and the assumption of \$15.5 million in debt. In addition to the purchase price, the estimated costs related to the acquisition, including professional fees, approximated \$5.0 million. The Company financed the acquisition with borrowings under its Credit Facility (see Note 8 below). Paravant, which is comprised of five operating units, is a designer and manufacturer of highly engineered, technically advanced, defense electronics for U.S. and allied international military and intelligence agency applications. The company manufactures rugged computer systems and communications interfaces serving military Command, Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance (C4ISR) initiatives. Paravant also produces high-speed processing equipment for the intelligence community and offers modernization design and installation services for select rotary- and fixed-wing military aircraft. The Paravant acquisition is highly compatible with the Company's goals of expanding its core tactical systems business base and increasing its presence in the U.S. Air Force and high-end signal intelligence programs supporting government agencies. The acquired Paravant operating units are managed as part of ESG.

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed in the Paravant acquisition. The Company is in the process of performing an assessment of the acquired contracts; thus, the preliminary allocation of the purchase price may change. The Company will complete the purchase price allocation in the first quarter of fiscal 2004.

(in thousands)	November 27, 2002
Accounts receivable	\$ 10,120
Inventory	12,108
Other current assets	1,449
Property, plant and equipment	6,482
Other assets	1,361
Acquired intangible assets	2,300
Goodwill	96,552
Total assets acquired	<u>130,372</u>
Accrual for future costs on acquired contracts	4,840
Other current liabilities	9,217
Long-term debt	15,469
Other liabilities	1,103
Total liabilities assumed	<u>30,629</u>
Net assets acquired	<u>\$ 99,743</u>

The \$96.6 million of goodwill was allocated to the Company's ESG operating segment, \$15.4 million of which is expected to be deductible for tax purposes. The \$2.3 million in acquired intangible assets was assigned to customer-related intangibles and is being amortized over a period of 20 years.

On October 15, 2002, the Company acquired DKD, Inc. (which operated under the name Nytech) for \$13.0 million plus contingent consideration. The \$13.0 million consists of a \$5.0 million cash payment and an \$8.0 million promissory note, bearing interest at a rate of 6%, with payments of \$5.0 million and \$3.0 million due on the first and second anniversaries of the closing, respectively. In addition to the purchase price, the estimated costs related to the acquisition, including professional fees, approximated \$0.5 million. Contingent consideration is based on an aggregate bookings earnout, as defined in the purchase agreement, and is not to exceed \$17.0 million in the aggregate. The earnout period began on the closing date of the acquisition and ends on March 31, 2009. Renamed DRS Nytech Imaging Systems, Inc. (DRS Nytech) and located in Irvine, California, the company manufactures and markets uncooled thermal imaging systems for portable weapons, head gear, hand-held devices and vehicle-mounted sights. The business also specializes in the design of stabilized, lightweight gimbals capable of controlling numerous sensors and suitable for mounting on a variety of land, sea and air platforms. The Nytech acquisition enhances DRS's position as a supplier of lightweight thermal imaging systems and supports the Company's objectives to further expand its position in

the uncooled infrared technology market. DRS Nytech operates as part of the Company's Electro-Optical Systems Group (EOSG).

The Company is in the process of obtaining a third-party valuation of certain assets acquired, as well as finalizing its own internal assessment of the acquired contracts; thus, the preliminary allocation of the purchase price may change. Based on preliminary purchase price allocations, the Company has estimated goodwill and acquired technology-related intangible assets to be \$10.2 million and \$4.0 million, respectively. Goodwill has been allocated to EOSG. The Company expects to complete the purchase price allocation in the first quarter of fiscal 2004.

Pursuant to a purchase agreement effective July 1, 2002, the Company acquired the assets and assumed certain liabilities of the Navy Controls Division (NCD) of Eaton Corporation for \$96.0 million in cash, subject to adjustment. In addition to the purchase price, the estimated costs related to the acquisition, including professional fees, approximated \$3.5 million. The Company financed the acquisition with existing cash on hand. Renamed DRS Power & Control Technologies, Inc. (DRS PCT) and located in Milwaukee, Wisconsin, and Danbury, Connecticut, the company is a leading supplier of high-performance power conversion, and instrumentation and control systems for the U.S. Navy's combatant fleet, including nuclear-powered and conventionally-powered ships, as well as for specialized industrial customers. Products include ship electric propulsion equipment, power electronics equipment, high-performance networks, shipboard control equipment and control panels, tactical displays, and specialty reactor instrumentation and control equipment. The addition of this unit complements the Company's presence in Naval advanced command and control computer display and other ship systems. DRS PCT operates as part of ESG.

The following table summarizes the final purchase price allocation of the NCD acquisition.

(in thousands)	July 1, 2002
Accounts receivable	\$ 16,237
Inventory	5,719
Property, plant and equipment	12,368
Goodwill	103,456
Acquired intangible assets	6,590
Total assets acquired	<u>144,370</u>
Accrual for future costs on acquired contracts	26,176
Accrued warranty	7,920
Other current liabilities	3,574
Postretirement liability	6,990
Other long-term liabilities	170
Total liabilities assumed	<u>44,830</u>
Net assets acquired	<u>\$ 99,540</u>

The \$103.5 million of goodwill was allocated to the Company's ESG operating segment, all of which is expected to be deductible for tax purposes. The \$6.6 million in acquired intangible assets was assigned to customer-related intangibles and is being amortized over a period of 20 years.

On April 11, 2002, the Company acquired the assets of the U.S.-based Unmanned Aerial Vehicle (UAV) business of Meggitt Defense Systems—Texas, Inc., a unit of Meggitt PLC, for \$0.8 million in cash. In addition to the purchase price, the costs related to the acquisition were approximately \$0.2 million. The business, located in Mineral Wells, Texas, and now operating as DRS Unmanned Technologies, Inc., provides close-range, low-weight, low-noise, medium-duration UAVs supporting military special operations missions. Applications for these products include tactical short-range surveillance, radio relay and C4ISR. The excess of costs over the net amounts allocated to the assets acquired and liabilities assumed in the acquisition (goodwill) and the appraised value of an identifiable intangible asset were \$3.9 million and \$0.3 million, respectively. The goodwill has been allocated to the Company's EOSG operating segment.

On September 28, 2001, DRS acquired certain assets and liabilities of the Sensors and Electronic Systems business of The Boeing Company (SES business). The Company paid \$60.1 million in cash, net of a \$7.0 million favorable working capital adjustment received in the fourth quarter of fiscal 2002, for the acquisition. In addition to the purchase price, the estimated costs related to the acquisition, including professional fees, approximated \$4.0 million. SES, located in Anaheim, California, is a provider of advanced electro-optical airborne and Naval surveillance and targeting systems, high-performance military infrared cooled sensor systems, and infrared uncooled sensor products for military and commercial applications. Production, engineering and management of the contracts acquired in the SES acquisition have been assigned, based on operational synergies, to two previously existing EOSG operating units, as well as a new operating unit called DRS Sensors & Targeting Systems, Inc. (DRS STS). DRS STS was created as a result of the SES acquisition, and it is also an operating unit of the Company's EOSG operating segment. This acquisition broadens the product lines and customer base of EOSG, particularly in those areas associated with Naval and air-based applications, and provides a strong complement to DRS's existing products in ground-based forward looking infrared technology.

During fiscal 2003, the Company finalized the purchase price allocation associated with its fiscal 2002 acquisition of the SES business. The following table summarizes the allocation of the assets acquired and liabilities assumed, as compared with the preliminary purchase price allocation recorded at March 31, 2002. The final purchase price allocation reflects a net increase to goodwill of \$22.6 million and a corresponding net adjustment to

inventory, accrual for future costs on acquired contracts, and property, plant and equipment.

(in thousands)	September 28, 2001
Accounts receivable	\$ 8,917
Inventory	6,049
Property, plant and equipment	7,666
Goodwill	87,109
Acquired intangible assets	14,000
Total assets acquired	<u>123,741</u>
Accrual for future costs on acquired contracts	58,579
Other current liabilities	5,024
Total liabilities assumed	<u>63,603</u>
Net assets acquired	<u>\$ 60,138</u>

The \$87.1 million of goodwill was allocated to the EOSG operating segment, all of which is expected to be deductible for tax purposes. The \$14.0 million in acquired intangible assets was assigned to customer-related intangibles, which are subject to amortization, and they have a weighted-average useful life of approximately 17 years.

On August 22, 2001, the Company acquired certain assets and liabilities of the Electro Mechanical Systems unit of Lockheed Martin Corporation for \$4.0 million in cash and \$0.3 million in acquisition-related costs. This company now operates as DRS Surveillance Support Systems, Inc. (DRS SSS), a unit of the Company's ESG operating segment, and is located in Largo, Florida. DRS SSS produces pedestals, support systems and antennae for radar and other surveillance sensor systems. The Company finalized its purchase price allocation during fiscal 2003 and recorded \$1.2 million of goodwill in connection with the acquisition, all of which has been allocated to ESG. The revised purchase price allocation was a result of the refinement of estimates to complete certain contracts as of the date of acquisition.

On June 14, 2000, the Company acquired the assets of General Atronics Corporation (GAC) for \$7.5 million in cash, \$4.0 million in common stock, representing 355,359 shares of DRS common stock, and \$0.4 million in acquisition-related costs. The Company funded the cash portion of this acquisition through borrowings under its previous revolving line of credit. Located in Wyndmoor, Pennsylvania and now operating as DRS Communications Company, LLC (DRS Communications Company), the company designs, develops and manufactures military data link components and systems, high-frequency communication modems, tactical and secure digital telephone components, and radar surveillance systems for U.S. and international militaries. DRS Communications Company operates as part of the Company's Flight Safety and Communications Group (FSCG). The Company recorded \$6.8 million of goodwill in connection with the acquisition.

All of the Company's acquisitions have been accounted for as purchase business combinations and are included in the Company's results of operations from their respective acquisition dates. Any additional payments are payable in cash and will be recorded as additional goodwill when the contingencies for such payments have been met. The Company records contract-related assets and liabilities acquired in business combinations at their fair value by considering the remaining contract amounts to be billed, DRS's estimate to complete and a reasonable profit allowance on the Company's completion effort commensurate with the profit margin that the Company earns on similar contracts.

The following unaudited pro forma financial information shows the results of operations for the years ended March 31, 2003 and 2002, as though the acquisitions of DRS PCT, DRS Nytech, Paravant, DRS EPT and DRS PTI had occurred on April 1, 2001. The fiscal 2002 and 2001 pro forma presentation shows the results of operations, as though the acquisition of the SES business occurred on April 1, 2000. The unaudited pro forma presentation reflects adjustments for: (i) the capitalization of general and administrative costs to be consistent with DRS's accounting practice, (ii) the amortization of acquired intangible assets, (iii) the elimination of goodwill amortization in certain periods presented to be consistent with DRS's April 1, 2001 adoption of SFAS 142, (iv) additional interest expense on acquisition-related borrowings and (v) the income tax effect on the pro forma adjustments, using a statutory tax rate of 42%. The pro forma adjustments related to certain acquisitions are based on preliminary purchase price allocations. Actual adjustments will be based on final appraisals and other analyses of fair values of acquired contracts, identifiable tangible and intangible assets, pensions and deferred tax assets and liabilities, which will be completed after third-party appraisals are obtained and all available data is reviewed. Differences between the preliminary and final purchase price allocations could have a significant impact on the unaudited pro forma financial information presented. The unaudited pro forma financial information below is presented for illustrative purposes only and is not necessarily indicative of the operating results that would have been achieved had the acquisition been completed as of the date indicated above or the results that may be obtained in the future.

(in thousands, except per-share data)	Unaudited Year Ended March 31,		
	2003	2002	2001
Revenues	\$771,638	\$755,455	\$535,949
Net earnings	\$ 35,018	\$ 22,455	\$ 7,582
Earnings per share of common stock:			
Basic earnings per share	\$ 1.90	\$ 1.67	\$ 0.72
Diluted earnings per share	\$ 1.84	\$ 1.55	\$ 0.66

Divestitures

On November 22, 2002, the Company sold its DRS Advanced Programs, Inc. (DRS API) operating unit for \$7.6 million in cash and recorded a \$0.6 million loss on the sale. DRS API, which operated as part of the Company's ESG operating segment, developed, designed, manufactured and marketed custom-packaged computers and peripherals, primarily for the Department of Defense and the government intelligence community. The Company wrote off \$2.3 million of goodwill in connection with the sale. The results of operations of DRS API, prior to the sale, are summarized as follows:

(in thousands)	Year Ended March 31,		
	2003	2002	2001
Revenues	\$ 8,507	\$15,843	\$12,784
Operating (loss) income	\$ (1,067)	\$ 125	\$ (101)

On May 27, 2002, the Company sold the assets of its DRS Ahead Technology operating unit. DRS Ahead Technology, which operated as part of the Company's "Other" operating segment, produced magnetic head components used in the manufacturing process of computer disk drives and manufactured magnetic video recording heads used in broadcast television equipment. The assets of DRS Ahead Technology were sold for their aggregate book value, and DRS received an interest bearing promissory note in the amount of \$3.1 million as consideration for the sale. The promissory note bears interest and is payable over an 80-month term. No gain or loss was recorded on the sale. The results of operations of DRS Ahead Technology, prior to the sale, are summarized as follows:

(in thousands)	Year Ended March 31,		
	2003	2002	2001
Revenues	\$ 1,349	\$9,209	\$9,651
Operating (loss) income	\$ (496)	\$ (369)	\$ 70

3. Goodwill and Related Intangible Assets

The following disclosure presents certain information regarding the Company's acquired intangible assets as of

March 31, 2003 and 2002. All intangible assets are being amortized over their estimated useful lives, as indicated below, with no estimated residual values.

(\$ in thousands)	Weighted Average Amortization Period	Gross Carrying Amount	Accumulated Amortization	Net Balance
As of March 31, 2003				
Amortized acquired intangible assets:				
Technology-based intangibles	21 years	\$26,955	\$(6,348)	\$20,607
Customer-related intangibles	19 years	27,400	(3,226)	24,174
Total		<u>\$54,355</u>	<u>\$(9,574)</u>	<u>\$44,781</u>
As of March 31, 2002				
Amortized acquired intangible assets:				
Technology-based intangibles	21 years	\$22,931	\$(5,155)	\$17,776
Customer-related intangibles	19 years	18,230	(1,873)	16,357
Total		<u>\$41,161</u>	<u>\$(7,028)</u>	<u>\$34,133</u>

The aggregate acquired intangible asset amortization expense for the fiscal years ended March 31, 2003, 2002 and 2001 was \$2.5 million, \$1.8 million and \$2.1 million, respectively. The estimated acquired intangible asset annual amortization expense for each of the subsequent five fiscal years ending March 31, 2008 is approximately \$2.7 million.

The table below reconciles the change in the carrying amount of goodwill by operating segment for the period from March 31, 2001 to March 31, 2003. These changes include the effects of the allocation of the purchase prices for the DRS Unmanned Technologies, Inc., DRS PCT, DRS Nytech, Paravant, DRS EPT and DRS PTI acquisitions in fiscal 2003 and the SES acquisition in fiscal 2002. Certain purchase price allocations are subject to change in fiscal 2004 (see Note 2 above). During fiscal 2002, DRS recorded increases to goodwill of \$3.8 million and \$2.9 million,

plus interest, for the settlement of working capital adjustments with Raytheon Company and Spar Aerospace Ltd., respectively. Also during fiscal 2002, the Company recorded a \$12.7 million reduction in goodwill in connection with the reduction of accruals on certain acquired contracts. As discussed in Note 2, the Company recorded a \$22.6 million net increase to ESG's goodwill during fiscal 2003. The increase is the result of the Company's finalization of its internal assessment of certain contracts acquired in connection with the SES acquisition, as well as an adjustment to acquired property, plant and equipment. Also during fiscal 2003, the Company recorded a \$1.2 million adjustment to ESG's goodwill, which was a result of the finalization of the purchase price allocation on the acquisition of DRS SSS. The Company's DRS API operating unit was sold in fiscal 2003 and, accordingly, ESG's goodwill was reduced by \$2.3 million.

(in thousands)	Electronic Systems Group	Electro- Optical Systems Group	Flight Safety and Communications Group	Other	Total
Balance as of March 31, 2001	\$ 31,450	\$ 20,236	\$24,661	\$43	\$ 76,390
Effect of adoption of SFAS 141 and 142:					
Workforce	—	3,807	3,064	—	6,871
Technical infrastructure	—	4,642	—	—	4,642
Other	—	—	742	—	742
Existing technology	—	—	(1,155)	—	(1,155)
Adjustments	—	—	—	(43)	(43)
Balance as of April 1, 2001	<u>31,450</u>	<u>28,685</u>	<u>27,312</u>	<u>—</u>	<u>87,447</u>
Fiscal 2002 acquisitions	—	64,593	—	—	64,593
Purchase price allocation adjustment	—	(12,691)	—	—	(12,691)
Working capital adjustments	—	3,823	2,908	—	6,731
Deferred tax asset adjustment – NAI acquisition	(3,354)	—	—	—	(3,354)
Foreign currency translation adjustment	31	—	(147)	—	(116)
Balance as of March 31, 2002	<u>28,127</u>	<u>84,410</u>	<u>30,073</u>	<u>—</u>	<u>142,610</u>
Fiscal 2003 acquisitions	256,484	14,088	—	—	270,572
Purchase price allocation adjustments on fiscal 2002 acquisitions	1,236	22,618	—	—	23,854
Sale of business unit	(2,323)	—	—	—	(2,323)
Foreign currency translation adjustment	790	—	1,360	—	2,150
Balance as of March 31, 2003	<u>\$284,314</u>	<u>\$121,116</u>	<u>\$31,433</u>	<u>\$—</u>	<u>\$436,863</u>

The table below presents net earnings, and basic and diluted EPS for the years ended March 31, 2003 and 2002, compared with those amounts in fiscal 2001, adjusted to exclude goodwill amortization, net of income taxes, as if SFAS 142 had been adopted April 1, 2000.

(in thousands, except per-share data)	Year Ended March 31,		
	2003	2002	2001
Reported net earnings	\$30,171	\$20,331	\$11,978
Add back:			
Goodwill and related intangible amortization, net of tax benefit of \$2,497	—	—	2,815
Adjusted net earnings	\$30,171	\$20,331	\$14,793
Basic earnings per share:			
Reported net earnings	\$ 1.64	\$ 1.52	\$ 1.14
Add back:			
Goodwill and related intangible amortization, net of tax benefit of \$0.24	—	—	0.27
Adjusted net earnings	\$ 1.64	\$ 1.52	\$ 1.41
Diluted earnings per share:			
Reported net earnings	\$ 1.58	\$ 1.41	\$ 1.01
Add back:			
Goodwill and related intangible amortization, net of tax benefit of \$0.20	—	—	0.23
Adjusted net earnings	\$ 1.58	\$ 1.41	\$ 1.24

4. Accounts Receivable

Unbilled receivables represent sales for which billings have not been presented to customers as of the end of the fiscal year, including retentions arising from contractual provisions. At March 31, 2003, retentions amounted to \$10.2 million, with approximately \$0.6 million anticipated to be collected beyond one year. The component elements of accounts receivable, net of allowances for doubtful accounts of \$2.9 million and \$1.4 million at March 31, 2003 and 2002, respectively, are as follows:

(in thousands)	March 31,	
	2003	2002
U.S. government contracts:		
Billed receivables	\$ 44,703	\$ 31,706
Unbilled receivables	23,485	12,876
	68,188	44,582
Other defense-related contracts:		
Billed receivables	72,886	44,533
Unbilled receivables	10,094	7,399
	82,980	51,932
Trade receivables	11,880	14,347
Total	\$163,048	\$110,861

5. Inventories

Inventories are summarized as follows:

(in thousands)	March 31,	
	2003	2002
Work-in-process	\$142,083	\$139,748
Raw material and finished goods	13,139	9,127
	155,222	148,875
Less progress payments and certain customer advances	(41,120)	(27,965)
Total	\$114,102	\$120,910

General and administrative costs included in inventory were \$23.2 million and \$16.3 million at March 31, 2003 and 2002, respectively. General and administrative costs included in costs and expenses amounted to \$122.1 million, \$99.0 million and \$78.6 million in fiscal 2003, 2002 and 2001, respectively. Included in these amounts are expenditures for internal research and development, amounting to \$14.4 million, \$9.5 million and \$8.0 million in fiscal 2003, 2002 and 2001, respectively.

6. Property, Plant and Equipment

Property, plant and equipment are summarized as follows:

(in thousands)	March 31,	
	2003	2002
Land	\$ 6,187	\$ 962
Laboratory and production equipment	68,304	55,389
Computer equipment	22,956	15,788
Buildings and improvements and leasehold improvements	31,012	16,453
Office furnishings, equipment and other	12,302	7,278
	140,761	95,870
Less accumulated depreciation and amortization	53,151	45,389
Total	\$ 87,610	\$50,481

Annual depreciation and amortization of property, plant and equipment amounted to \$13.4 million, \$10.7 million and \$8.6 million in fiscal 2003, 2002 and 2001, respectively.

7. Accrued Expenses and Other Current Liabilities

The component elements of accrued expenses and other current liabilities are as follows:

(in thousands)	March 31,	
	2003	2002
Accruals for future costs related to acquired contracts (Note 2)	\$ 70,362	\$ 51,896
Customer advances	46,040	23,983
Payroll, other compensation and related expenses	32,588	20,653
Accrued product warranty	19,365	10,319
Accrual for future costs on uncompleted contracts	7,108	9,324
Income taxes payable	6,176	5,651
Other	31,058	20,434
Total	\$212,697	\$142,260

8. Debt

A summary of debt is as follows:

(in thousands)	March 31,	
	2003	2002
Term notes	\$212,525	\$139,300
Other obligations	12,550	421
	225,075	139,721
Less:		
Current installments of long-term debt	7,717	1,435
Short-term bank debt	521	226
Total long-term debt	\$216,837	\$138,060

On November 26, 2002, the Company entered into a \$338.6 million amended and restated credit agreement (the Credit Facility) with Wachovia Bank, N.A. as the Administrative Agent to fund the Paravant acquisition. The Credit Facility consists of a \$125.0 million senior secured revolving line of credit and a \$213.6 million senior secured term loan facility. The maturity dates of the revolving line of credit and the term loan are September 30, 2006 and September 30, 2008, respectively. The term loan requires quarterly principal payments of \$537,500 through September 30, 2007 and four equal quarterly payments of \$50.7 million thereafter ending on September 30, 2008. The Credit Facility is secured by a lien on substantially all of DRS's assets. Borrowings under this Credit Facility bear interest, at the Company's option, at either: a "base rate," as defined in the credit agreement, equal to the higher of 0.50% per annum above the latest prime rate and federal funds rate, plus a spread ranging from 1.25% to 2.25% per annum, depending on the Company's Total Leverage Ratio (TLR) at the time of determination; or a LIBOR rate, as defined in the Credit Facility, plus a spread ranging from 2.25% to 3.25% per annum, depending on the Company's TLR. The TLR is defined as total debt minus performance-based letters of credit, as compared with EBITDA, as defined in the credit agreement. The Company pays commitment fees calculated on the average daily unused portion of its revolving line of credit at a rate of 0.50% per annum, provided that the amount of outstanding swingline loans, as defined in the credit agreement, shall not be considered usage of the revolving line of credit for the purpose of calculating such commitment fee. The Company pays commissions and issuance fees on its outstanding letters of credit and is obligated to pay or reimburse the issuing lender of any letters of credit for such normal and customary costs and expenses incurred or charged by the issuing lender in issuing, effecting payment under, amending or otherwise administering any letter of credit. Letter-of-credit commissions are calculated at a rate ranging from 2.25% to 3.00% per annum, depending on the Company's TLR ratio at the time of issuance, multiplied by the face amount of such letter of credit.

Letter-of-credit issuance fees are charged at 0.125% per annum multiplied by the face amount of such letter of credit. Both letter-of-credit commissions and issuance fees are paid quarterly.

The Company previously had a \$240 million credit agreement with a syndicate of lenders, with Wachovia Bank, N.A. as the Lead Lender, consisting of a term loan in the aggregate principal amount of \$140 million and a \$100 million revolving line of credit. Repayment terms, collateral, interest rates and other charges under the previous facility were substantially the same as those pursuant to the amended and restated credit agreement described above.

There are certain covenants and restrictions placed on DRS under its Credit Facility, including a maximum TLR and a minimum fixed-charge ratio, as defined in the credit agreement, a maximum amount of capital expenditures, a restriction on the payment of dividends on DRS's capital stock, a limitation on the issuance of additional debt, a requirement that the Company offer to make prepayments on its term loans outstanding with 50% of the aggregate net cash proceeds from any equity offering if DRS's adjusted leverage ratio, as defined, exceeds 2.00 to 1.00, and certain other restrictions. The Company was in compliance with all covenants under its Credit Facility at March 31, 2003. Amounts available under the revolving line of credit are based upon a borrowing base calculation, as defined in the credit agreement, which principally is based on accounts receivable and inventory balances. As of March 31, 2003, the Company had \$99.5 million of additional available credit, after satisfaction of its borrowing base requirement.

As of March 31, 2003, \$212.5 million of term loans were outstanding against the Credit Facility, in addition to which \$25.5 million was contingently payable under letters of credit, as

compared with amounts outstanding and contingently payable at March 31, 2002 of \$139.3 million and \$11.6 million, respectively, under the previous facility. The effective interest rates on the term loans were 4.4% and 5.3%, as of March 31, 2003 and 2002, respectively. The Company enters into standby letter-of-credit agreements with financial institutions and customers primarily relating to the guarantee of the Company's future performance on certain contracts to provide products and services and to secure advanced payments it has received from customers. There were no borrowings under the Company's revolving line of credit as of March 31, 2003 and 2002.

On November 27, 2002, the Company acquired a mortgage note payable with its acquisition of Paravant. The note is secured by the DRS Tactical Systems' facility located in Palm Bay, Florida, and bears interest at a rate equal to the one-month LIBOR plus 1.65%. Effective April 1, 2001, Paravant entered into a 15-year interest rate swap with an original notional amount of \$3.6 million to receive interest at a variable rate equal to the one-month LIBOR and to pay interest at a fixed rate of 7.85% (see Note 1 above). The balance of the mortgage as of March 31, 2003 was \$3.3 million. Payments of principal and interest will continue through December 1, 2016.

On October 15, 2002, the Company issued an \$8.0 million promissory note, bearing interest at 6% per annum, related to the Nytech acquisition. Payments of \$5.0 million and \$3.0 million are due on the first and second anniversaries of the closing, respectively.

The aggregate maturities of long-term debt for fiscal 2004, 2005, 2006, 2007 and 2008 are \$7.7 million, \$5.5 million, \$2.4 million, \$2.3 million and \$102.7 million per year, respectively, and \$103.8 million thereafter.

9. Supplemental Cash Flow Information

(in thousands)	Year Ended March 31,		
	2003	2002	2001
Supplemental disclosure of cash flow information			
Cash paid for:			
Interest	\$11,315	\$ 9,547	\$11,518
Income taxes	\$18,663	\$12,679	\$ 9,175
Supplemental disclosure of non-cash investing and financing activities			
Acquisition costs for business combinations	\$ 5,119	\$ 655	\$ —
Common stock issued for purchase of GAC	\$ —	\$ —	\$ 4,000
Fixed assets	\$ 884	\$ —	\$ —
Note receivable – sale of operating unit	\$ 3,070	\$ —	\$ 1,741
Promissory note – Nytech acquisition	\$ 8,000	\$ —	\$ —
Conversion of 9% convertible debentures	\$ —	\$ —	\$18,870

10. Income Taxes

Earnings before income taxes consist of the following:

(in thousands)	Year Ended March 31,		
	2003	2002	2001
Earnings before income taxes:			
Domestic earnings	\$49,878	\$36,943	\$29,384
Foreign earnings (losses)	5,994	1,418	(4,430)
Total	\$55,872	\$38,361	\$24,954

Income tax expense consists of the following:

(in thousands)	Year Ended March 31,		
	2003	2002	2001
Income tax expense (benefit)			
Current:			
Federal	\$13,782	\$11,466	\$ 8,962
State	3,226	2,760	2,654
Foreign	1,560	896	1,647
	18,568	15,122	13,263
Deferred:			
Federal	4,516	1,130	844
State	1,811	136	928
Foreign	806	1,642	(2,059)
	7,133	2,908	(287)
Total	\$25,701	\$18,030	\$12,976

Deferred income taxes reflect the impact of temporary differences between amounts of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws. The tax effects of temporary differences that gave rise to significant portions of the deferred tax assets and deferred tax liabilities at March 31, 2003 and 2002 are as follows:

(in thousands)	March 31,	
	2003	2002
Deferred tax assets:		
Acquired federal net operating loss (NOL) carryforwards	\$ 5,984	\$ 6,438
State NOL carryforwards	3,394	3,775
Foreign NOL carryforwards	4,051	3,681
Costs accrued on uncompleted contracts	6,638	5,933
Inventory capitalization	4,921	3,331
Other	1,202	3,754
Total gross deferred tax assets	26,190	26,912
Less valuation allowance	(7,088)	(5,435)
Deferred tax assets	19,102	21,477
Deferred tax liabilities:		
Depreciation and amortization	2,276	943
Long-term contract costs	10,717	8,860
Federal impact of state benefits	595	510
Other	2,403	2,874
Deferred tax liabilities	15,991	13,187
Net deferred tax assets	\$ 3,111	\$ 8,290

A valuation allowance is provided when it is more likely than not that some portion or all of a deferred tax asset will not be realized. The Company has established a valuation allowance for a portion of the deferred tax assets attributable to state and foreign net operating loss (NOL) carryforwards at March 31, 2003 and 2002, due to the uncertainty of future earnings of certain subsidiaries of the Company and the status of applicable statutory regulations that could limit or preclude utilization of these benefits in future periods. During the fiscal year ended March 31, 2003, the valuation allowance increased by \$1.7 million as follows: There was a \$1.5 million increase in the valuation allowance associated with the U.K. NOL and temporary differences for DRS Tactical Systems Ltd. (fka DRS Rugged Systems (Europe) Ltd.), due to the uncertainty of the operating unit's future profitability. Valuation allowances associated with various state NOLs increased by \$0.2 million, as well. During the fiscal year ended March 31, 2002, the valuation allowance increased by a net amount of \$1.0 million as follows: The valuation allowance attributable to certain temporary differences in the amount of \$1.3 million was released, due to a change in the expectation of the utilization of such temporary differences, primarily as a result of a change in the Internal Revenue Code with regard to the separate return limitation rules. Since the valuation allowance was established as a result of the Company's fiscal 1999 NAI Technologies, Inc. (NAI) acquisition, the change of such valuation allowance did not reduce income tax expense, but rather reduced goodwill. The \$0.6 million valuation allowance associated with the U.K. NOL for DRS Hadland Ltd. was released, due to the operating unit's increased profitability. There was a \$2.9 million increase in the valuation allowance associated with the U.K. NOL and temporary differences for DRS Tactical Systems Ltd., due to the uncertainty of the operating unit's future profitability. Based upon the level of historical taxable income and projections for future taxable income over the period in which the Company's deferred tax assets are deductible, management believes it is more likely than not the Company will realize the benefits of these deductible differences, net of the existing valuation allowances at March 31, 2003 and 2002.

The Company considers earnings of its foreign subsidiaries to be reinvested permanently. While these earnings would be subject to additional tax if repatriated, such repatriation is not anticipated. Any additional amount of tax is not practicable to estimate.

Current and noncurrent deferred tax assets (liabilities) of \$6.8 million and \$(3.7) million, and \$3.4 million and \$4.9 million, respectively, are included in the Consolidated Balance Sheets as of March 31, 2003 and 2002, respectively. At March 31, 2003, \$17.0 million of U.S. federal and \$27.0 million of state NOL carryforwards, which expire between fiscal years 2004 and 2023, and \$13.5 million of foreign NOLs, which carry forward indefinitely,

were available. All of the Company's U.S. federal and \$8.9 million of its state NOL carryforwards were acquired in connection with the NAI acquisition. The annual utilization of these NAI NOL carryforwards is limited under certain provisions of the Internal Revenue Code. Any future utilization of these net operating loss carryforwards will result in an adjustment to goodwill to the extent it reduces the valuation allowance.

A reconciliation of the expected U.S. federal income tax rate to the actual (effective) income tax rate is as follows:

	Year Ended March 31,		
	2003	2002	2001
Expected U.S. federal income tax expense	35.0%	35.0%	35.0%
Difference between U.S. and foreign tax rates	—%	0.6%	1.5%
State income tax rate, net of federal income tax benefit	5.5%	5.0%	8.0%
Nondeductible expenses	1.8%	3.0%	5.8%
Change in valuation allowance	2.9%	5.7%	—
Foreign investment tax credits	(1.4)%	(2.5)%	—
Other	2.2%	0.2%	1.7%
Total	46.0%	47.0%	52.0%

The provision for income taxes includes all estimated income taxes payable to federal, state and foreign governments, as applicable.

11. Common Stock and Stock Compensation Plans

Common Stock As of March 31, 2003, the authorized capital of the Company was composed of 30.0 million shares of common stock (22,421,986 shares issued) and 2.0 million shares of preferred stock (no shares issued). During fiscal 2001, the Company cancelled all stock held in treasury.

On December 20, 2002, the Company issued 5,462,500 shares of its common stock in a public offering for \$28.00 per share, including shares related to an over-allotment option that was granted to the underwriters. The Company received net proceeds of \$144.3 million, net of underwriters' fees and other costs associated with the offering of \$8.6 million. Approximately \$12.0 million of the proceeds were used during the third quarter of fiscal 2003 to repay certain debt balances assumed in connection with the Company's November 27, 2002 acquisition of Paravant (see Note 2 above). The balance of the proceeds was used for the Kaman Electromagnetics Development Center and Power Technology Incorporated acquisitions and to provide funds for potential future acquisitions and working capital needs.

On December 19, 2001, the Company issued 3,755,000 shares of its common stock in a public offering for \$32.00 per share, including shares related to an over-allotment option that was granted to the underwriters. The Company received net proceeds of \$112.6 million, net of underwriters' fees and other costs associated with the offering of \$7.6 million. The Company used \$24.0 million of the net proceeds of the offering to repay the outstanding balance of its revolving line of credit and retained the balance to fund future acquisitions and working capital needs.

In connection with the fiscal 2001 acquisition of General Atronics Corporation, the Company issued 355,359 shares of common stock.

Stock Compensation Plans The 1991 Stock Option Plan (the Plan), which was approved by the Company's stockholders on August 8, 1991, provided for the grant of options to purchase a total of 600,000 shares of DRS common stock through February 6, 2001. Upon the expiration of the Plan on February 6, 2001, a total of 161,550 shares of common stock remained ungranted. Options still outstanding at the time of the Plan's expiration remain in effect, as granted. Shares of DRS common stock are no longer reserved for future grants under the Plan.

On June 17, 1996, the Board of Directors adopted, and on August 7, 1996, the stockholders approved, the 1996 Omnibus Plan (Omnibus Plan). Under the terms of the Omnibus Plan,

options may be granted to key employees, directors and consultants of the Company. The Omnibus Plan was initially limited to 500,000 shares of DRS common stock and has since been increased, with stockholder approval, to 3,875,000 shares. Awards under the Omnibus Plan are at the discretion of the Executive Compensation Committee and may be made in the form of: (i) incentive stock options, (ii) non-qualified stock options, (iii) stock appreciation rights, (iv) restricted stock, (v) phantom stock, (vi) stock bonuses and (vii) other awards. Unless the Executive Compensation Committee expressly provides otherwise, options granted under the Omnibus Plan have a term of ten years and generally are not exercisable prior to one year after the date of grant with 25% of the shares granted exercisable on each of the first four anniversaries of the date of grant. As of March 31, 2003, 888,643 shares remained for future grants under the Omnibus Plan.

Pursuant to the terms of exercise under the grant, the excess of the fair-market value of shares under option at the date of grant over the option price may be charged to unamortized stock compensation or to earnings as compensation expense and credited to additional paid-in capital. The unamortized stock compensation, if any, is charged to earnings as it becomes exercisable, in accordance with the terms of the grant. The amount of compensation charged to earnings in fiscal 2003, 2002 and 2001 was approximately \$46,000, \$218,000 and \$206,000, respectively.

A summary of stock option activity is as follows:

	Number of Shares of Common Stock	Weighted Average Exercise Price
Outstanding at March 31, 2000	1,684,071	\$ 8.76
Granted	532,600	\$13.42
Exercised	(225,579)	\$ 9.15
Expired or cancelled	(57,562)	\$ 8.55
Outstanding at March 31, 2001	1,933,530	\$ 9.99
Granted	652,207	\$33.56
Exercised	(454,317)	\$ 8.33
Expired or cancelled	(18,600)	\$18.97
Outstanding at March 31, 2002	2,112,820	\$17.52
Granted	767,850	\$32.10
Exercised	(125,434)	\$ 8.95
Expired or cancelled	(54,187)	\$27.22
Outstanding at March 31, 2003	2,701,049	\$21.87

As of March 31, 2003, 2002 and 2001, 1,177,841, 754,078 and 792,668 options were exercisable, respectively, at weighted average exercise prices of \$13.53, \$10.07 and \$9.15, respectively.

In connection with the Company's acquisition of NAI during fiscal 1999, each issued and outstanding NAI warrant to purchase NAI common stock at an exercise price of \$2.50 per share was converted into DRS warrants at a conversion ratio of 0.25 of a share of DRS common stock to one share of NAI common stock. These warrants expired on February 15, 2002 and were exercised in full with the exception of 401 shares that were not presented for exercise. Each issued and outstanding NAI stock option, whether vested or unvested, was assumed by DRS using the same conversion ratio as was used for the warrants, but rounded down to the nearest whole number. The terms and conditions under

which the stock options were granted prior to the acquisition, with the exception of the exercise price and number of shares, remained the same. The Company issued 603,175 warrants and assumed 161,230 converted stock options, respectively.

During fiscal 1999, the Board of Directors issued options to purchase 250,000 shares of DRS common stock with vesting terms similar to awards issued in fiscal 1999 under the Omnibus Plan at exercise prices in excess of the market price on the date of grant. The per-share weighted-average fair value and exercise price of these options were \$1.89 and \$10.44, respectively.

The stock options exercised during fiscal 2000 include 50,000 shares, which are being held by the Company in "book entry" form. Book entry shares are not considered issued or outstanding as of March 31, 2003. However, these shares are included in the Company's diluted earnings per share calculations for fiscal 2003, 2002 and 2001.

Information regarding all options outstanding at March 31, 2003 follows:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Number of Options	Weighted Average Exercise Price
Less than \$7.76	323,037	\$ 7.35	5.7 years	234,875	\$ 7.46
\$7.76 – \$11.00	517,200	\$ 9.93	5.2 years	517,200	\$ 9.93
\$11.01 – \$26.10	560,152	\$14.92	7.8 years	271,502	\$13.99
\$26.11 – \$33.33	643,640	\$32.08	9.6 years	390	\$33.33
Greater than \$33.33	657,020	\$34.33	8.7 years	153,874	\$33.99
Total	2,701,049	\$21.87	7.7 years	1,177,841	\$13.53

12. Pensions and Other Employee Benefits

In connection with the acquisitions of the Boeing SES business and the Navy Controls Division of Eaton Corporation (see Note 2 above), the Company established defined benefit plans for certain of those employees who transferred to DRS at the time of the acquisitions. In addition, DRS maintains a defined benefit pension plan for certain employees of its Canadian operating unit. Eligibility for participation in the plans varies, and benefits are generally based on the participant's compensation and years of service, as defined. The Company's funding policy is generally to contribute in accordance with cost accounting standards that affect government contractors, subject to the Internal Revenue Code and regulations therein. Plan assets are invested primarily in U.S. government and U.S. government agency instruments, listed stocks and bonds.

Postretirement medical benefits are provided to certain retired employees and dependents of the Navy Controls Division of Eaton Corporation, as well as the Company's Canadian operating unit. Participants are eligible for these benefits when they retire from active service and meet the eligibility requirements for the Company's pension plans. These benefits are funded primarily by the Company in accordance with cost accounting standards that affect government contractors, subject to the Internal Revenue Code and regulations therein, with the retiree generally paying a portion of the costs through contributions, deductibles and coinsurance provisions.

The Company also maintains two non-contributory and unfunded supplemental retirement plans: the Supplemental Executive Retirement Plan (DRS SERP), which was established on February 1, 1996 for the benefit of certain key executives; and the DRS Supplemental Retirement Plan (DRS SRP), which was established for the benefit of certain employees who were

transferred to DRS in connection with the Company's fiscal 1998 acquisition of certain assets of the Electro-Optical Systems and Focal Plane Array businesses of Raytheon Company. Pursuant to the DRS SERP, the Company will provide retirement benefits to each key executive, based on years of service and final average annual compensation, as defined therein. The DRS SRP benefits

are based on the eligible employees' final average earnings, as defined, and their Social Security benefit.

The following table summarizes the balance sheet impact, as well as the benefit obligations, assets and funded status associated with the pension, postretirement and supplemental retirement plans plans.

(in thousands)	Funded Defined Benefit Pension Plans		Funded Postretirement Benefit Plans	Unfunded Supplemental Retirement Plans	
	2003	2002	2003	2003	2002
Change in benefit obligation					
Benefit obligation at beginning of year	\$ 17,169	\$ —	\$ —	\$ 7,377	\$ 4,039
Benefit obligation assumed through acquisition	22,215	16,086	6,990	—	2,948
Addition of a plan	1,586	—	499	—	—
Service cost	2,605	500	326	413	308
Interest cost	2,604	583	414	520	376
Plan participants' contributions	60	—	—	—	—
Actuarial (gain) loss	1,490	—	577	(262)	(220)
Benefits paid	(118)	—	(9)	(74)	(74)
Exchange rate differences	150	—	43	—	—
Benefit obligation at end of year	\$ 47,761	\$ 17,169	\$ 8,840	\$ 7,974	\$ 7,377
Change in plan assets					
Fair value of plan assets at beginning of year	\$ 15,900	\$ —	\$ —	\$ —	\$ —
Fair value of plan assets assumed through acquisition	22,068	15,900	—	—	—
Addition of a plan	1,504	—	—	—	—
Actual return on plan assets	(262)	—	—	—	—
Plan participants' contributions	60	—	—	—	—
Employer contributions	231	—	705	74	74
Benefits paid	(118)	—	(9)	(74)	(74)
Exchange rate differences	135	—	—	—	—
Fair value of plan assets at end of year	\$ 39,518	\$ 15,900	\$ 696	\$ —	\$ —
Net amount recognized					
Funded status of the plans	\$ (8,243)	\$ (1,269)	\$ (8,144)	\$ (7,974)	\$ (7,377)
Unrecognized loss	5,767	735	1,089	749	1,081
Unrecognized prior service cost	—	—	—	3,325	3,586
Net amount recognized	\$ (2,476)	\$ (534)	\$ (7,055)	\$ (3,900)	\$ (2,710)
Amounts recognized in the Consolidated Balance Sheets consist of					
Intangible asset	\$ —	\$ —	\$ —	\$ 1,624	\$ 1,371
Accrued benefit liability	(2,476)	(534)	(7,055)	(5,524)	(4,081)
Net amount recognized	\$ (2,476)	\$ (534)	\$ (7,055)	\$ (3,900)	\$ (2,710)

As required by SFAS No. 87, "Employers' Accounting for Pensions" (SFAS 87), where the accumulated benefit obligation exceeds the fair value of plan assets, the Company has recognized in the Consolidated Balance Sheets at March 31, 2003 and 2002

the additional minimum liability of the unfunded accumulated benefit obligation of \$1.6 million and \$1.4 million, respectively, as a long-term liability with an offset to deferred income taxes and other noncurrent assets.

The net periodic expense related to the plans includes the following components:

(in thousands)	Funded Defined Benefit Pension Plans		Funded Postretirement Benefit Plans	Unfunded Supplemental Retirement Plans		
	2003	2002	2003	2003	2002	2001
Components of net periodic expense:						
Service cost	\$2,605	\$500	\$326	\$ 413	\$308	\$195
Interest cost	2,604	583	414	520	376	221
Expected return on plan assets	(3,184)	(735)	—	—	—	—
Amortization of unrecognized prior service cost	—	—	27	331	245	133
Net periodic expense	\$2,025	\$348	\$767	\$1,264	\$929	\$549

The following weighted-average actuarial assumptions were used to determine the benefit obligation and the net costs related to the plans:

	Funded Defined Benefit Pension Plans		Funded Postretirement Benefit Plans	Unfunded Supplemental Retirement Plans	
	2003	2002	2003	2003	2002
Rate assumptions					
Discount rate	6.70%	7.25%	6.70%	6.70%	7.13%
Expected return on plan assets	9.25%	9.25%	—	—	—
Increase in future compensation levels	3.60%	5.80%	—	3.90%	5.00%

The annual increase in cost of benefits (health care cost trend rate) is assumed to be an average of 12% in fiscal 2004 and is assumed to gradually decrease to a rate of 4.5% in fiscal 2009 and thereafter. Assumed health care cost trend rates have a significant effect on amounts reported for postretirement medical benefit plans. A one percentage point decrease in the assumed health care cost trend rates would have the effect of decreasing the aggregate service and interest cost by \$13,995 and the postretirement medical obligations by \$112,601. A one percentage point increase

in the assumed health care cost trend rate would have the effect of increasing the aggregate service and interest cost by \$10,298 and the postretirement medical obligations by \$86,834.

The Company maintains defined contribution plans covering substantially all domestic full-time eligible employees. The Company's contributions to these plans for fiscal 2003, 2002 and 2001 amounted to \$6.0 million, \$3.3 million and \$2.3 million, respectively.

13. Commitments, Contingencies and Related Party Transactions

At March 31, 2003, the Company was party to various noncancellable operating leases (principally for administration, engineering and production facilities) with minimum rental payments as follows:

(in thousands)	
2004	\$26,334
2005	14,385
2006	12,566
2007	10,866
2008	7,939
Thereafter	14,340
Total	<u>\$86,430</u>

It is not certain as to whether the Company will negotiate new leases as existing leases expire. Determinations to that effect will be made as existing leases approach expiration and will be based on an assessment of the Company's capacity requirements at that time.

Net rent expense aggregated \$18.9 million, \$14.3 million and \$11.3 million in fiscal 2003, 2002 and 2001, respectively.

Effective July 20, 1994, the Company entered into an Employment, Non-Competition and Termination Agreement with David E. Gross (the Gross Agreement), who retired as President and Chief Technical Officer of the Company on May 12, 1994. Under the terms of the Gross Agreement, Mr. Gross received compensation for his services under a five-year consulting agreement and a five-year non-compete arrangement. The payments were charged to expense over the five-year term, as services were performed and obligations were fulfilled by Mr. Gross. Upon conclusion of the initial five-year period, Mr. Gross began receiving an aggregate of \$1.3 million, payable over a nine-year period as deferred compensation. The approximate net present value of the deferred compensation payments to be made to Mr. Gross is included in other liabilities in the Consolidated Balance Sheets.

In April and May 1998, subpoenas were issued to the Company by the United States Attorney for the Eastern District of New York seeking documents related to a governmental investigation of certain equipment manufactured by DRS Photronics, Inc. (DRS Photronics). These subpoenas were issued in connection with United States v. Tress, a criminal complaint against a then employee of DRS Photronics, alleging that improper

test data was provided in connection with boresighting equipment furnished to the U.S. Army. On June 26, 1998, the complaint against the employee was dismissed without prejudice. Additional subpoenas were issued to the Company on August 12, 1999 and May 10, 2000, relating to the ongoing investigation of DRS Photronics and one or more of its then employees. On May 17, 2002, DRS Photronics announced that it had entered into a global settlement with the government, resolving all potential allegations related to the investigation. Under the terms of the settlement, DRS Photronics agreed to pay \$2.5 million in restitution and pleaded guilty to a violation of the False Claims Act.

During fiscal 2003, the Company settled a dispute with Spar Aerospace Ltd. (Spar) with respect to the working capital adjustment provided for in the purchase agreement between DRS and Spar dated as of September 19, 1997, pursuant to which the Company acquired, through certain of its subsidiaries, certain assets of Spar. Under the terms of this settlement, DRS agreed to pay Spar a working capital adjustment of CAN\$4,616,000 (or approximately US\$3,000,000) and CAN\$723,654 (or approximately US\$460,000) in interest. During fiscal 2002, the Company accrued \$3.9 million, including interest, associated with the dispute. In connection with this settlement, the parties agreed to release each other from all claims arising out of or relating to the working capital adjustment provision in the purchase agreement and to discontinue all legal actions relating thereto.

On October 3, 2001, a lawsuit was filed in the United States District Court of the Eastern District of New York by Miltope Corporation, a corporation of the State of Alabama, and IV Phoenix Group, Inc., a corporation of the State of New York, against DRS Technologies, Inc., DRS Electronic Systems, Inc. and a number of individual defendants, several of whom are employed by DRS Electronic Systems, Inc. The plaintiffs allege claims against the Company of infringement of a number of patents, breach of a confidentiality agreement, misappropriation of trade secrets, unjust enrichment and unfair competition. The claims relate generally to the activities of certain former employees of IV Phoenix Group and the hiring of some of those employees by DRS. The plaintiffs seek damages of not less than \$5.0 million for each of the claims. The plaintiffs also allege claims for tortious interference with business relationships, tortious interference with contracts and conspiracy to breach fiduciary duty. The plaintiffs seek damages of not less than \$47.1 million for each claim. In addition, the plaintiffs seek punitive and treble damages, injunctive relief and attorney's fees. In our answer, the Company has denied the plaintiffs' allegations and intends to vigorously defend this action. In February 2002, the plaintiffs filed an amended complaint,

which eliminated the patent infringement claims and added claims related to statutory and common-law trademark infringement. Although this action is still in discovery, the Company believes that it has meritorious defenses and does not believe the action will have a material adverse effect on its consolidated earnings, financial condition or liquidity.

The Company is a party to various legal actions and claims arising in the ordinary course of its business. In the Company's opinion, the Company has adequate legal defenses for each of the actions and claims, and believes that their ultimate disposition will not have a material adverse effect on the Company's consolidated financial position or results of operations.

Since a substantial amount of the Company's revenues is derived from contracts or subcontracts with the U.S. government and foreign governments, future revenues and profits will be dependent upon continued contract awards, Company performance and volume of government business. The books and records of the Company are subject to audit and post-award review by the Defense Contract Audit Agency and similar foreign agencies.

14. Operating Segments

DRS operates in three principal business segments on the basis of products and services offered: Electronic Systems Group (ESG), Electro-Optical Systems Group (EOSG) and Flight Safety and Communications Group (FSCG). Separate and distinct businesses comprise each operating segment. All other operations are combined in Other.

ESG is a supplier of combat display systems, digital information processing systems, power generation, conversion, distribution, propulsion and control systems, and battlefield digitization systems for sea, air and land applications supporting military modernization and transformation initiatives. ESG also produces radar surveillance and tracking systems, acoustic signal processing systems, flat panels and other computer peripherals, signal intelligence products, ship networks and middleware to promote interoperability and compatibility with the military's new and existing systems. ESG's products are used on various front-line platforms, such as ships, amphibious operation platforms, surveillance aircraft, submarines and mobile ground platforms, and the Group's power systems are installed on every combatant ship in the U.S. Navy, including destroyers, aircraft carriers and attack submarines.

EOSG produces systems and subsystems for infrared night vision and targeting systems for the U.S. Army's Abrams Main Battle Tanks, Bradley Fighting Vehicles, OH-58D Kiowa Warrior helicopters, Aegis destroyers and cruisers, and High-Mobility Multipurpose Wheeled Vehicle Scouts, among other platforms. EOSG designs, manufactures and markets these and other products that allow operators to detect, identify and target objects based upon their infrared signatures, regardless of the ambient light level. The Group is one of two key suppliers to the U.S. government for advanced focal plane array technology. In addition to the Group's military applications, EOSG also manufactures electro-optical modules for commercial devices used in corrective laser eye surgery and provides system integration for retinal scanning and imaging devices.

FSCG is a manufacturer of airborne deployable recorders and surveillance and communications systems. FSCG's products are used by U.S. and international militaries, as well as commercial customers. The Group produces integrated naval ship communications systems, information management systems, mission recorders, coastal and border surveillance and radar systems, ultra high-speed digital imaging systems for F/A-18 aircraft and industrial purposes, and multiple-platform weapons calibration systems for air platforms, such as the AH-64 Apache attack helicopter and the AC-130U gunship. FSCG also provides electronic manufacturing services to the defense and space industries.

Other includes the activities of DRS Corporate Headquarters and DRS Ahead Technology (for the period it was owned by the Company during the first quarter of fiscal 2003) and certain non-operating subsidiaries of the Company. The assets of DRS Ahead Technology were sold on May 27, 2002 (see Note 2 above). DRS Ahead Technology produced magnetic head components used in the manufacturing process of computer disk drives, which burnish and verify the quality of disk surfaces. DRS Ahead Technology also serviced and manufactured magnetic video recording heads used in broadcast television equipment.

Transactions between segments generally are negotiated and accounted for under terms and conditions that are similar to other government and commercial contracts; however, these intercompany transactions are eliminated in consolidation. Other accounting policies of the segments are consistent with those described in the summary of significant accounting policies (see Note 1 above). The Company evaluates segment-level performance based on revenues and operating income, as

presented in the Consolidated Statements of Earnings. Operating income, as shown, includes amounts allocated from DRS

Corporate operations using an allocation methodology prescribed by U.S. government regulations for government contractors. Information about the Company's operating segments follows:

(in thousands)	ESG	EOSG	FSCG	Other	Total
Fiscal 2003					
Total revenues	\$292,794	\$276,581	\$113,934	\$ 1,349	\$684,658
Intersegment revenues	(1,038)	(218)	(7,640)	—	(8,896)
External revenues	\$291,756	\$276,363	\$106,294	\$ 1,349	\$675,762
Operating income (loss)	\$ 18,733	\$ 37,168	\$ 12,605	\$ (822)	\$ 67,684
Identifiable assets	\$466,155	\$287,209	\$105,958	\$112,799	\$972,121
Depreciation and amortization	\$ 4,403	\$ 8,630	\$ 2,300	\$ 1,327	\$ 16,660
Capital expenditures	\$ 3,121	\$ 11,641	\$ 717	\$ 6,047	\$ 21,526
Fiscal 2002					
Total revenues	\$206,654	\$208,883	\$ 99,106	\$ 9,209	\$523,852
Intersegment revenues	(37)	(662)	(5,953)	—	(6,652)
External revenues	\$206,617	\$208,221	\$ 93,153	\$ 9,209	\$517,200
Operating income (loss)	\$ 18,053	\$ 27,365	\$ 5,090	\$ (739)	\$ 49,769
Identifiable assets	\$127,391	\$248,604	\$111,016	\$114,080	\$601,091
Depreciation and amortization	\$ 1,914	\$ 7,153	\$ 2,907	\$ 1,815	\$ 13,789
Capital expenditures	\$ 2,618	\$ 7,553	\$ 1,694	\$ 1,718	\$ 13,583
Fiscal 2001					
Total revenues	\$186,731	\$148,227	\$ 87,055	\$ 9,651	\$431,664
Intersegment revenues	(257)	(65)	(3,736)	—	(4,058)
External revenues	\$186,474	\$148,162	\$ 83,319	\$ 9,651	\$427,606
Operating income (loss)	\$ 15,336	\$ 23,646	\$ (747)	\$ (704)	\$ 37,531
Identifiable assets	\$106,627	\$112,154	\$ 97,791	\$ 18,368	\$334,940
Depreciation and amortization	\$ 3,447	\$ 6,972	\$ 4,029	\$ 1,797	\$ 16,245
Capital expenditures	\$ 2,239	\$ 10,099	\$ 2,216	\$ 1,631	\$ 16,185

Revenues, total assets, and property, plant and equipment by geographic location are presented in the table below. Revenues are attributed to countries based on the physical location of the

operating unit generating the revenues. Information about the Company's operations in these geographic locations for each of the three years ended March 31, 2003 is as follows:

(in thousands)	Total	United States	Canada	United Kingdom
Fiscal 2003				
Revenues	\$675,762	\$613,568	\$35,718	\$26,476
Total assets	\$972,121	\$891,498	\$36,443	\$44,180
Property, plant and equipment, net	\$ 87,610	\$ 84,087	\$ 2,209	\$ 1,314
Fiscal 2002				
Revenues	\$517,200	\$464,758	\$31,228	\$21,214
Total assets	\$601,091	\$534,347	\$37,485	\$29,259
Property, plant and equipment, net	\$ 50,481	\$ 46,674	\$ 2,518	\$ 1,289
Fiscal 2001				
Revenues	\$427,606	\$380,279	\$26,964	\$20,363
Total assets	\$334,940	\$273,178	\$33,162	\$28,600
Property, plant and equipment, net	\$ 37,639	\$ 34,343	\$ 2,046	\$ 1,250

Export sales accounted for approximately 13%, 15% and 14% of total revenues in the fiscal years ended March 31, 2003, 2002 and 2001, respectively.

15. Unaudited Quarterly Financial Information

The following table sets forth unaudited quarterly financial information for fiscal 2003 and 2002:

(in thousands, except per-share data)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Fiscal year ended March 31, 2003				
Revenues	\$131,238	\$161,196	\$167,540	\$215,788
Operating income	\$ 12,673	\$ 16,723	\$ 16,570	\$ 21,718
Net earnings	\$ 5,434	\$ 7,663	\$ 7,406	\$ 9,668
Basic earnings per share	\$ 0.32	\$ 0.45	\$ 0.42	\$ 0.43
Diluted earnings per share	\$ 0.31	\$ 0.44	\$ 0.41	\$ 0.42
Fiscal year ended March 31, 2002				
Revenues	\$103,352	\$116,178	\$141,238	\$156,432
Operating income	\$ 9,684	\$ 10,703	\$ 13,878	\$ 15,504
Net earnings	\$ 3,898	\$ 4,483	\$ 5,371	\$ 6,579
Basic earnings per share	\$ 0.32	\$ 0.37	\$ 0.42	\$ 0.40
Diluted earnings per share	\$ 0.30	\$ 0.34	\$ 0.38	\$ 0.38



**To the Board of Directors and Stockholders,
DRS Technologies, Inc.:**

We have audited the accompanying consolidated balance sheets of DRS Technologies, Inc. and subsidiaries as of March 31, 2003 and 2002 and the related consolidated statements of earnings, stockholders' equity and comprehensive earnings and cash flows for each of the years in the three-year period ended March 31, 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of DRS Technologies, Inc. and subsidiaries as of March 31, 2003 and 2002, and the results of their operations and their cash flows for each of the years in the three-year period ended March 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, the Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 141, "Business Combinations" for all business combinations consummated after June 30, 2001 and the provisions of SFAS No. 142, "Goodwill and Other Intangible Assets" effective April 1, 2001.

KPMG LLP

Short Hills, New Jersey
May 13, 2003

DIRECTORS

Ira Albom

Senior Vice President, Teleflex, Inc.

The Honorable Dr. Donald C. Fraser

Professor, Boston University;
Former Deputy Under Secretary of
Defense, Acquisition

William F. Heitmann

Senior Vice President and Treasurer,
Verizon Communications, Inc.

The Honorable Steven S. Honigman

Partner, Thelen Reid and Priest LLP;
Former General Counsel to the
Department of the Navy

C. Shelton James

President, C.S. James and Associates

Mark N. Kaplan

Of Counsel, Skadden, Arps, Slate,
Meagher & Flom LLP

Mark S. Newman

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President and Chief Executive Officer,
DRS Technologies, Inc.

RADM Stuart F. Platt, USN (Ret.)

Chairman of the Board, The Wornick
Company; Former Competition Advocate
General of the U.S. Navy

GEN Dennis J. Reimer, USA (Ret.)

Director, National Memorial Institute
for the Prevention of Terrorism;
Former Chief of Staff of the U.S. Army

Eric J. Rosen

Managing Director, Onex Investment Corp.

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VADM Michael L. Bowman, USN (Ret.)

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President and Chief Executive Officer

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Senior Vice President, Human Resources

Patricia M. Williamson

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Christopher Wright

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A Partnership
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DRS Signal Technologies, Inc.

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DRS Tactical Systems, Inc.

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DRS Tactical Systems (West), Inc.

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DRS Technical Services, Inc.

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DRS Optronics, Inc.

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DRS Flight Safety and Communications

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Canada

DRS Flight Safety and Communications

700 Palladium Drive
Kanata, Ontario K2V 1C6
Canada

ANNUAL MEETING

The annual meeting of stockholders will be held at 11:00 a.m. ET on Wednesday, August 6, 2003 at The Penn Club of New York, 30 West 44th Street, New York, New York 10036.

INVESTOR INQUIRIES

The Company files an annual report on Form 10-K with the Securities and Exchange Commission. Stockholders may obtain copies of this report free of charge by writing to Patricia M. Williamson, Vice President, Corporate Communications/Investor Relations, DRS Technologies, Inc., 5 Sylvan Way, Parsippany, New Jersey 07054, by e-mailing p.williamson@drs.com or by visiting the Company's web site at <http://www.drs.com>.

STOCK EXCHANGE LISTING

The Common Stock of DRS Technologies is traded on the New York Stock Exchange under the symbol DRS and on the Berlin Stock Exchange under the symbol DZ1.

TRANSFER AGENT

Shares of DRS Technologies, Inc. may be transferred by contacting Mellon Investor Services, 85 Challenger Road, Ridgefield Park, New Jersey 07660, phone 800.851.9677, <http://www.mellon-investor.com>.

INDEPENDENT AUDITORS

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150 John F. Kennedy Parkway
Short Hills, New Jersey 07078

EQUAL OPPORTUNITY EMPLOYER

DRS Technologies is an Equal Opportunity Employer. The Company's policies regarding recruiting, hiring, compensation, benefits, promotions, transfers, training and all other personnel matters are free from discriminatory practices.

WEB SITE

<http://www.drs.com>

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