

DYNCORP INTERNATIONAL INC.

Form 10-Q

February 11, 2009

**Table of Contents**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

**(Mark One)**

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

**For the quarterly period ended January 2, 2009**

**or**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number: 001-32869**

**DYNCORP INTERNATIONAL INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**01-0824791**

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

**3190 Fairview Park Drive, Suite 700, Falls Church, Virginia 22042**

**(571) 722-0210**

(Address, including zip code, and telephone number, including area code,  
of registrant's principal executive offices)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of February 2, 2009, the registrant had 57,000,000 shares of its Class A common stock, par value \$0.01 per share, outstanding.

**DYNCORP INTERNATIONAL INC.  
TABLE OF CONTENTS**

	<b>Page</b>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
<u>Item 1. Financial Statements (unaudited)</u>	3
<u>Unaudited Condensed Consolidated Statements of Income Three Months Ended January 2, 2009 and December 28, 2007</u>	3
<u>Unaudited Condensed Consolidated Statements of Income Nine Months Ended January 2, 2009 and December 28, 2007</u>	4
<u>Unaudited Condensed Consolidated Balance Sheets January 2, 2009 and March 28, 2008</u>	5
<u>Unaudited Condensed Consolidated Statements of Cash Flows Nine Months Ended January 2, 2009 and December 28, 2007</u>	6
<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	7
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	26
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	40
<u>Item 4. Controls and Procedures</u>	41
<b><u>PART II. OTHER INFORMATION</u></b>	
<u>Item 1. Legal Proceedings</u>	42
<u>Item 1A. Risk Factors</u>	42
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	42
<u>Item 3. Defaults Upon Senior Securities</u>	42
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	42
<u>Item 5. Other Information</u>	42
<u>Item 6. Exhibits</u>	43
<u>Exhibit 10.1</u>	
<u>Exhibit 31.1</u>	
<u>Exhibit 31.2</u>	
<u>Exhibit 32.1</u>	
<u>Exhibit 32.2</u>	



**Table of Contents****PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****DYNCORP INTERNATIONAL INC.****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME***(Amounts in thousands, except per share data)*

	<b>For the Three Months Ended</b>	
	<b>January 2,</b>	<b>December 28, 2007</b>
	<b>2009</b>	
Revenue	\$ 792,327	\$ 523,071
Cost of services	(704,210)	(452,341)
Selling, general and administrative expenses	(26,505)	(28,995)
Depreciation and amortization expense	(10,029)	(10,910)
Operating income	51,583	30,825
Interest expense	(15,322)	(14,052)
Loss on early extinguishment of debt		
Earnings from affiliates	1,319	1,253
Interest income	730	522
Other income, net	(856)	380
Income before income taxes	37,454	18,928
Provision for income taxes	(11,639)	(6,968)
Income before minority interest	25,815	11,960
Minority interest	(6,062)	
Net income	\$ 19,753	\$ 11,960
Basic earnings per share	\$ 0.35	\$ 0.21
Diluted earnings per share	\$ 0.34	\$ 0.21

See notes to condensed consolidated financial statements.

**Table of Contents**

**DYNCORP INTERNATIONAL INC.**  
**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
*(Amounts in thousands, except per share data)*

	<b>For the Nine Months Ended</b>	
	<b>January 2, 2009</b>	<b>December 28, 2007</b>
Revenue	\$ 2,288,272	\$ 1,566,853
Cost of services	(2,039,118)	(1,358,062)
Selling, general and administrative expenses	(80,350)	(79,916)
Depreciation and amortization expense	(30,594)	(31,901)
Operating income	138,210	96,974
Interest expense	(44,442)	(42,247)
Loss on early extinguishment of debt	(4,443)	
Earnings from affiliates	3,959	3,320
Interest income	1,751	2,202
Other income, net	809	(162)
Income before income taxes	95,844	60,087
Provision for income taxes	(30,086)	(21,916)
Income before minority interest	65,758	38,171
Minority interest	(15,154)	
Net income	\$ 50,604	\$ 38,171
Basic earnings per share	\$ 0.89	\$ 0.67
Diluted earnings per share	\$ 0.88	\$ 0.67

See notes to condensed consolidated financial statements.

**Table of Contents**

**DYNCORP INTERNATIONAL INC.**  
**UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**  
*(Amounts in thousands, except share data)*

	<b>January 2, 2009</b>	<b>As of March 28, 2008</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 150,580	\$ 85,379
Restricted cash	18,039	11,308
Accounts receivable, net of allowances of \$8 and \$268, respectively	634,924	513,312
Prepaid expenses and other current assets	125,756	109,027
Deferred income taxes		17,341
Total current assets	929,299	736,367
Property and equipment, net	18,022	15,442
Goodwill	420,180	420,180
Tradenname	18,318	18,318
Other intangibles, net	151,151	176,146
Deferred income taxes	5,773	18,168
Other assets, net	31,506	18,088
Total assets	\$ 1,574,249	\$ 1,402,709
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Current portion of long-term debt	\$	\$ 3,096
Accounts payable	209,116	148,787
Accrued payroll and employee costs	111,579	85,186
Deferred income taxes	1,927	
Other accrued liabilities	121,582	129,240
Income taxes payable	5,347	8,245
Total current liabilities	449,551	374,554
Long-term debt, less current portion	615,903	590,066
Other long-term liabilities	12,121	13,804
Commitments and contingencies		
Minority interest	11,848	
Shareholders equity:		
Common stock, \$0.01 par value 232,000,000 shares authorized; 57,000,000 shares issued and outstanding	570	570
Additional paid-in capital	365,887	357,026
Retained earnings	124,207	73,603
Accumulated other comprehensive loss	(5,838)	(6,914)

Total shareholders' equity	484,826	424,285
Total liabilities and shareholders' equity	\$ 1,574,249	\$ 1,402,709

See notes to condensed consolidated financial statements.



**Table of Contents**

**DYNCORP INTERNATIONAL INC.**  
**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
*(Amounts in thousands)*

	<b>For the Nine Months Ended</b>	
	<b>January 2, 2009</b>	<b>December 28, 2007</b>
<b>Cash flows from operating activities</b>		
Net income	\$ 50,604	\$ 38,171
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	31,388	32,924
Amortization of deferred loan costs	2,696	2,261
(Recovery) for losses on accounts receivable	(283)	(1,127)
Earnings from affiliates	(3,959)	(3,320)
Dividends from affiliates	2,439	2,652
Deferred income taxes	32,193	313
Equity-based compensation	2,385	3,360
Minority interest	15,154	
Loss on early extinguishment of debt	4,443	
Other	(772)	(138)
Changes in assets and liabilities:		
Restricted cash (see Note 1)	8,429	10,133
Accounts receivable	(121,329)	(120,018)
Prepaid expenses and other current assets	(20,711)	(22,546)
Accounts payable and accrued liabilities	68,957	11,832
Income taxes payable	(1,439)	(3,753)
Net cash provided by (used in) operating activities	70,195	(49,256)
<b>Cash flows from investing activities</b>		
Purchase of property and equipment	(3,407)	(2,822)
Purchase of computer software	(1,634)	(996)
Change in cash restricted as collateral on letters of credit (see Note 1)	(15,160)	
Contributions to affiliates	(2,231)	(3,366)
Other investing activities	362	(57)
Net cash (used in) investing activities	(22,070)	(7,241)
<b>Cash flows from financing activities</b>		
Borrowings under debt agreements (see Note 5)	323,751	13,500
Repayments on debt agreements (see Note 5)	(301,129)	(37,058)
Net borrowings (payments) under other financing arrangements	4,299	(8,957)
Payments of deferred financing cost	(9,834)	
Other net financing activities	(11)	138
Net cash provided by (used in) financing activities	17,076	(32,377)

Edgar Filing: DYNACORP INTERNATIONAL INC. - Form 10-Q

Net increase in cash and cash equivalents	65,201		(88,874)
Cash and cash equivalents, beginning of period	85,379		102,455
Cash and cash equivalents, end of period	\$ 150,580	\$	13,581
Income taxes paid (net of refunds)	\$ 18,622	\$	21,949
Interest paid	\$ 34,354	\$	33,231
Non-cash sale of DIFZ including related financing (see Note 8)	\$ 8,296	\$	

See notes to condensed consolidated financial statements.

**Table of Contents**

**DYNCORP INTERNATIONAL INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1 Basis of Presentation and Accounting Policies**

*Basis of Presentation*

DynCorp International Inc., through its subsidiaries, is a leading provider of specialized mission-critical professional and support services outsourced by the U.S. military, non-military U.S. governmental agencies and foreign governments. Our specific global expertise is in law enforcement training and support, security services, base and logistics operations, construction management, aviation services and operations and linguist services. We also provide logistics support for all our services. References herein to DynCorp International, the Company, we, our, or us refer to DynCorp International Inc. and its subsidiaries unless otherwise stated or indicated by the context.

The condensed consolidated financial statements include the accounts of the Company and its domestic and foreign subsidiaries. These condensed consolidated financial statements have been prepared by the Company, without audit, pursuant to accounting principles generally accepted in the United States of America ( GAAP ) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. However, the Company believes that all disclosures are adequate to make the information presented not misleading. These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and the related notes thereto included in the Company's 2008 Annual Report on Form 10-K, filed with the Securities and Exchange Commission (the SEC ) on June 10, 2008.

The Company reports its results on a 52/53-week fiscal year with the fiscal year ending on the Friday closest to March 31 of such year (April 3, 2009 for fiscal year 2009 which is a 53-week fiscal year). The nine-month fiscal period ended January 2, 2009 was a 40-week period from March 29, 2008 to January 2, 2009. The nine-month fiscal period ended December 28, 2007 was a 39-week period from March 31, 2007 to December 28, 2007.

In the opinion of management, all adjustments necessary to fairly present the Company's financial position at January 2, 2009 and March 28, 2008, the results of operations for the three and nine months ended January 2, 2009 and December 28, 2007, and cash flows for the nine months ended January 2, 2009 and December 28, 2007, have been included and are of a normal and recurring nature. The results of operations for the three and nine months ended January 2, 2009 are not necessarily indicative of the results to be expected for the full fiscal year or for any future periods. The Company uses estimates and assumptions required for preparation of the financial statements. The estimates are primarily based on historical experience and business knowledge and are revised as circumstances change. However, actual results could differ from the estimates.

For purposes of comparability, certain prior year amounts, specifically our segment reporting structure as further discussed in Note 14, have been reclassified to conform to the current year presentation. Such reclassifications have no impact on previously reported net income.

*Principles of Consolidation*

The consolidated financial statements include the accounts of the Company and its domestic and foreign subsidiaries. All intercompany transactions and balances have been eliminated in consolidation. Generally, investments in which the Company owns a 20% to 50% ownership interest are accounted for by the equity method. These investments are in business entities in which the Company does not have control, but has the ability to exercise significant influence over operating and financial policies and is not the primary beneficiary as defined in Financial Accounting Standards Board (the FASB ) Interpretation No. 46R (Revised 2003), *Consolidation of Variable Interest Entities* ( FIN No. 46R ). The Company has no investments in business entities of less than 20%.

**Table of Contents**

The following table sets forth the Company's ownership in joint ventures and companies that are not consolidated into the Company's financial statements as of January 2, 2009, and are accounted for by the equity method. Economic rights are indicated by the ownership percentages listed below.

DynEgypt LLC	50.0%
TSDI Pty Ltd	50.0%
Dyn Puerto Rico Corporation	49.9%
Contingency Response Services LLC	45.0%
Babcock DynCorp Limited	44.0%
Partnership for Temporary Housing LLC	40.0%
DCP Contingency Services LLC	40.0%

On July 31, 2008, the Company sold 50% of its ownership interest in its previously wholly owned subsidiary, DynCorp International FZ-LLC ( DIFZ ), for approximately \$8.2 million. DIFZ was previously a wholly owned subsidiary and therefore consolidated into the Company's financial statements. No gain has been recognized on the sale as of January 2, 2009 as the Company completely financed the transaction by accepting three promissory notes provided by the purchaser. As a result, the sale was accounted for as a capital transaction reflected in additional paid in capital ( APIC ). Repayment of the notes to the Company is to be made through a single cash payment of \$500,000 with the remainder to be repaid through the purchaser's portion of DIFZ quarterly dividends. The sale price is contingent upon a revaluation based on actual DIFZ results through January 31, 2009, with any adjustments to the purchase price to be reflected by an increase or decrease in the notes. Additionally, the interest component of the three notes receivable held by the Company will also increase APIC due to the structure of this transaction and will not impact the Company's consolidated statements of income. The sale agreement governing the transaction provides indemnification to the buyer for losses arising out of tax related matters specific to DIFZ. After the transaction, it was determined that the Company was the primary beneficiary as defined in FIN No. 46R.

The following table sets forth the Company's ownership in joint ventures that are consolidated into the Company's financial statements as of January 2, 2009. For the entities list below, the Company is the primary beneficiary as defined in FIN No. 46R.

Global Linguist Solutions LLC	51.0%
DynCorp International FZ-LLC	50.0%

*Minority Interest*

We record the impact of our joint venture partners' interests in consolidated joint ventures as minority interest. Minority interest is presented on the face of the income statement as an increase or reduction in arriving at net income. The presentation of minority interest on the balance sheet is typically located in a mezzanine account between liabilities and equity. As of March 28, 2008, the minority interest balance related to Global Linguist Solutions LLC ( GLS ) was recorded as an asset within prepaid expenses and other current assets, due to cumulative losses incurred. As of January 2, 2009, all minority interest, including minority interest related to DIFZ, were recorded as mezzanine equity.

*Restricted Cash*

Restricted cash represents cash restricted by certain contracts in which advance payments are not available for use except to pay specified costs and vendors for work performed on the specific contract and cash restricted and invested as collateral as required by our letters of credit. Changes in restricted cash related to our contracts are included as operating activities whereas changes in restricted cash for funds invested as collateral are included as investing activities in the consolidated statements of cash flows.

**Table of Contents**

The following table reconciles our restricted cash to the cash flow statement:

<i>(amounts in thousands)</i>	<b>January 2, 2009</b>	<b>As of March 28, 2008</b>	<b>Cash provided by/ (used in)</b>
<i>Type of restricted cash</i>			
Contract related	\$ 2,879	\$ 11,308	\$ 8,429
Required as collateral	15,160		(15,160)
 Total	 \$ 18,039	 \$ 11,308	 \$ (6,731)

*Accounting Policies*

There have been no material changes to our significant accounting policies as detailed in Note 1 of our 2008 Annual Report on Form 10-K filed with the SEC on June 10, 2008.

*Accounting Developments**Pronouncements Implemented*

In September 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standard ( SFAS ) No. 157, Fair Value Measurements ( SFAS No. 157 ). SFAS No. 157 establishes a single definition of fair value and a framework for measuring fair value under GAAP and expands disclosures about fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements; however, it does not require any new fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position No. 157-2, Effective Date of FASB Statement No. 157 , which provides a one year deferral of the effective date of SFAS No. 157 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. In October 2008, the FASB issued Staff Position No. FAS 157-3, Determining the Fair Value of a Financial Asset in a Market That Is Not Active , which clarifies the application of FAS 157 in a market that is not active and defines additional key criteria in determining the fair value of a financial asset when the market for that financial asset is not active. The adoption of SFAS No. 157 did not have a material impact on our consolidated financial condition and results of operations. See Note 12 for the applicable fair value disclosures.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 ( SFAS No. 159 ). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. It provides entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The adoption of SFAS No. 159 did not impact our consolidated financial condition and results of operations as we did not elect to apply the fair value option to items that have previously been measured at historical cost.

**Table of Contents**

*Pronouncements Not Yet Implemented*

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* ( SFAS No. 141R ). This statement replaces FASB Statement No. 141, *Business Combinations* ( SFAS No. 141 ). This statement retains the fundamental requirements in SFAS No. 141 that the acquisition method of accounting (which SFAS No. 141 called the purchase method) be used for all business combinations and for an acquirer to be identified for each business combination. This statement defines the acquirer as the entity that obtains control of one or more businesses in the business combination and establishes the acquisition date as the date that the acquirer achieves control. This statement requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with limited exceptions specified in the statement. This statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008, with the exception of the accounting for valuation allowances on deferred taxes and acquired tax contingencies associated with acquisitions. SFAS No. 141R amends SFAS No. 109, *Accounting for Income Taxes* such that adjustments made to valuation allowances on deferred taxes and acquired tax contingencies associated with acquisitions that closed prior to the effective date of SFAS No. 141R would also apply the provisions of SFAS No. 141R. We do not expect the provisions of SFAS No. 141R to have a material impact on our consolidated financial statements unless we complete a business combination.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, which is an amendment of Accounting Research Bulletin No. 51. This statement clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. This statement changes the way the consolidated income statement is presented, thus requiring consolidated net income to be reported at amounts that include the amounts attributable to both parent and the noncontrolling interest. This statement is effective for the fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. We are currently evaluating the potential impact of SFAS No. 160 on our consolidated financial statements.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, *Disclosures about Derivative Instruments and Hedging Activities* ( SFAS No. 161 ). SFAS No. 161 is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. The provisions of SFAS No. 161 are effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. We do not expect the provisions of SFAS No. 161 to have a material impact on our consolidated financial statements.

In April 2008, the FASB issued Staff Position No. 142-3, *Determination of the Useful Life of Intangible Assets* ( FSP No. 142-3 ). FSP No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets* ( SFAS No. 142 ). FSP No. 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years; however, early adoption is not permitted. We are currently evaluating the potential impact of FSP No. 142-3 on our consolidated financial statements.

**Table of Contents****Note 2 Earnings Per Share**

Basic earnings per share is based on the weighted average number of common shares outstanding during each period. Diluted earnings per share is based on the weighted average number of common shares outstanding and the effect of all dilutive common stock equivalents during each period. As of January 2, 2009, the only common stock equivalent was restricted stock units. These restricted stock units may be dilutive and included or anti-dilutive and excluded in future earnings per share calculations as they are liability awards as defined by SFAS 123R. The following table reconciles the numerators and denominators used in the computations of basic and diluted earnings per share:

	For the Three Months		For the Nine Months Ended	
	January	December 28,	January	December 28,
(Amounts in thousands, except per share data)	2, 2009	2007	2, 2009	2007
<b>Numerator</b>				
Net income	\$ 19,753	\$ 11,960	\$ 50,604	\$ 38,171
<b>Denominator</b>				
Weighted average common shares basic	57,000	57,000	57,000	57,000
Weighted average effect of dilutive securities:				
Restricted stock units	437		324	
Weighted average common shares diluted	57,437	57,000	57,324	57,000
Basic earnings per share	\$ 0.35	\$ 0.21	\$ 0.89	\$ 0.67
Diluted income per share	\$ 0.34	\$ 0.21	\$ 0.88	\$ 0.67

**Note 3 Goodwill and Other Intangible Assets***Goodwill*

The Company conducts its annual goodwill impairment test as of the end of February of each fiscal year. During the second quarter of fiscal year 2009, indicators of potential impairment, specifically the operational results of the Afghanistan construction business, caused the Company to conduct an interim impairment test. The result of this impairment test did not indicate impairment had occurred at that time.

During the third quarter of fiscal year 2009, the Company determined that a second interim impairment analysis as of January 2, 2009 would be prudent due to the continued challenges in its Afghanistan construction business. In accordance with SFAS No. 142, the Company completed step one of the impairment analysis and concluded that, as of January 2, 2009, the fair value of the Operations Maintenance and Construction Management ( OMCM ) reporting unit was greater than the respective carrying value, including goodwill indicating the reporting unit's goodwill was not impaired.

The Company used income and market based approaches, which involved a discounted cash flow analysis and a valuation analysis. The estimates and assumptions used in assessing the fair value of the reporting unit and the valuation of the underlying assets and liabilities are inherently subject to significant uncertainties. These analyses also require management to make assumptions and estimates and review relevant industry and market data. The contracts in the OMCM reporting unit not related to Afghanistan Construction, as well as forecasted new business, were among the significant factors in the OMCM impairment analysis.

The changes in the carrying amount of goodwill for the nine months ended January 2, 2009 are as follows:

(Amounts in thousands)	ISS <sup>(1)</sup>	LCM	MTSS	Total
Balance as of March 28, 2008	\$ 340,029	\$	\$ 80,151	\$ 420,180
Transfer between reporting segments <sup>(2)</sup>	(39,935)	39,935		

Balance as of January 2, 2009	\$ 300,094	\$ 39,935	\$ 80,151	\$ 420,180
-------------------------------	------------	-----------	-----------	------------

- (1) Balance as of March 28, 2008 represents the goodwill balance of the Government Services ( GS ) segment. International Security Services ( ISS ) and Logistics and Construction Management ( LCM ) did not exist as reportable segments at that date. On April 1, 2008, the Company announced it would change from reporting financial results of two segments, GS and Maintenance and Technical Support Services ( MTSS ), to reporting three segments, beginning with the first fiscal quarter of 2009. This was accomplished by splitting GS into two distinct reporting segments, ISS and LCM.
- (2) Transfer between reporting segments as described further in Note 14, is the result of a reorganization of



the Company's reporting structure within its segments and a contemporaneous independent fair value analysis of the reporting units within the Company's reporting segments, in the manner required by SFAS No. 142.

**Table of Contents***Intangible Assets*

The following tables provide information about changes relating to intangible assets:

<b>January 2, 2009</b>					
<i>(Amounts in thousands, except years)</i>	<b>Weighted Average Useful Life  (Years)</b>		<b>Gross Carrying Value</b>	<b>Accumulated Amortization</b>	<b>Net</b>
<i>Finite-lived intangible assets:</i>					
Customer-related intangible assets	8.5	\$	290,716	\$ (146,492)	\$ 144,224
Other	5.2		14,978	(8,051)	6,927
			\$ 305,694	\$ (154,543)	\$ 151,151
Indefinite-lived intangible assets Tradename		\$	18,318	\$	\$ 18,318

<b>March 28, 2008</b>					
<i>(Amounts in thousands, except years)</i>	<b>Weighted Average Useful Life  (Years)</b>		<b>Gross Carrying Value</b>	<b>Accumulated Amortization</b>	<b>Net</b>
<i>Finite-lived intangible assets:</i>					
Customer-related intangible assets	8.5	\$	290,716	\$ (119,997)	\$ 170,719
Other	4.2		10,887	(5,460)	5,427
			\$ 301,603	\$ (125,457)	\$ 176,146
Indefinite-lived intangible assets Tradename		\$	18,318	\$	\$ 18,318

Amortization expense for customer-related and other intangibles was \$9.5 million and \$10.4 million for the three months ended January 2, 2009 and December 28, 2007, respectively, and \$29.1 million and \$30.4 million for the nine months ended January 2, 2009 and December 28, 2007, respectively.

The following schedule outlines an estimate of future amortization based upon the finite-lived intangible assets owned at January 2, 2009:

<i>(Amounts in thousands)</i>	<b>Amortization Expense</b>
Three month period ended April 3, 2009	\$ 9,506
Estimate for fiscal year 2010	37,550
Estimate for fiscal year 2011	33,240
Estimate for fiscal year 2012	22,654
Estimate for fiscal year 2013	19,123
Thereafter	29,078

Total \$ 151,151

**Note 4 Accounts Receivable**

Accounts Receivable, net consisted of the following:

<i>(Amounts in thousands)</i>	<b>January 2, 2009</b>	<b>March 28, 2008</b>
Billed	\$ 265,132	\$ 193,337
Unbilled	369,792	319,975
Total	\$ 634,924	\$ 513,312

**Table of Contents**

Unbilled receivables at January 2, 2009 and March 28, 2008 include \$38.3 million and \$52.8 million, respectively, related to costs incurred on projects for which the Company has been requested by the customer to begin work under a new contract or extend work under an existing contract, and for which formal contracts or contract modifications have not been executed at the end of the fiscal period. These amounts include \$5.3 million related to contract claims at January 2, 2009 and March 28, 2008. The balance of unbilled receivables consists of costs and fees billable on contract completion or other specified events, substantially all of which is expected to be billed and collected within one year.

**Note 5 Long-Term Debt**

Long-term debt consisted of the following:

<i>(Amounts in thousands)</i>	<b>January 2, 2009</b>	<b>March 28, 2008</b>
Term loans	\$ 200,000	\$ 301,130
9.5% Senior subordinated notes <sup>(1)</sup>	415,903	292,032
	615,903	593,162
Less current portion of long-term debt		(3,096)
Total long-term debt	\$ 615,903	\$ 590,066

- (1) Senior subordinated notes are net of a \$1.1 million unamortized discount as of January 2, 2009. There was no unamortized discount as of March 28, 2008.

Future maturities of long-term debt for the three months ending April 3, 2009 and each of the fiscal years subsequent to April 3, 2009 were as follows:

<i>(Amounts in thousands)</i>	
Three months ending April 3, 2009	\$
2010	16,875
2011	50,625
2012	55,500
2013	494,032
Thereafter	
Total long-term debt (including current portion) <sup>(1)</sup>	\$ 617,032

- (1) Future maturities of long-term debt

include  
\$1.1 million  
unamortized  
discount as of  
January 2, 2009,  
which is  
presented net in  
the financial  
statements.

***Senior Secured Credit Facility***

On July 28, 2008 the Company entered into a senior secured credit facility (the *Credit Facility* ) consisting of a revolving credit facility of \$200.0 million (including a letter of credit sub facility of \$125.0 million) (the *Revolving Facility* ) and a senior secured term loan facility of \$200.0 million (the *Term Loan Facility* ). The maturity date of the *Revolving Facility* and the *Term Loan Facility* is August 15, 2012. Quarterly principal payments will begin on September 22, 2009 and end on the maturity date of August 15, 2012. The scheduled quarterly *Term Loan Facility* payments beginning on September 22, 2009, are considered long term since the Company has the intent and ability to make a revolver borrowing equal to or greater than the quarterly payments in order to maintain hedge accounting on the full \$200.0 million through May 22, 2010, as disclosed in Note 10. The *Credit Facility* is subject to various financial covenants, including a total leverage ratio, an interest coverage ratio, maximum capital expenditures and certain limitations based upon eligible accounts receivable. Borrowings under the *Credit Facility* are secured by substantially all the assets of the Company and the capital stock of its subsidiaries.

On July 28, 2008, the Company borrowed \$200.0 million under the *Term Loan Facility* at the applicable three-month LIBOR ( *London Interbank Offered Rate* ) plus the applicable margin then in effect to refinance certain existing indebtedness and pay certain transaction costs related to the *Credit Facility* and the offering of additional senior subordinated notes, as described below. The applicable margin for LIBOR as of January 2, 2009 was 2.5% per annum, resulting in an effective interest rate under the *Term Loan Facility* of 4.3% per annum. This rate is fully hedged through the Company's swap agreements as disclosed in Note 10.

**Table of Contents**

Borrowings under the Revolving Facility bear interest at a rate per annum equal to either the Alternate Base Rate plus an applicable margin determined by reference to the leverage ratio, as set forth in the Credit Facility ( Applicable Margin ) or LIBOR plus the Applicable Margin. As of both January 2, 2009 and March 28, 2008, the Company had no outstanding borrowings under the Revolving Facility.

Our available borrowing capacity under the Revolving Facility totaled \$185.8 million at January 2, 2009, which gives effect to \$14.2 million of outstanding letters of credit under the letter of credit sub facility. With respect to each letter of credit, a quarterly commission in an amount equal to the face amount of such letter of credit multiplied by the Applicable Margin and a nominal fronting fee are required to be paid. The combined rate as of January 2, 2009 was 2.6%.

As of January 2, 2009, the Company also had \$14.4 million of letters of credit outstanding that were not part of the Revolving Facility. These letters of credit are collateralized by \$15.2 million of restricted cash, which is recorded as such in the Company's consolidated balance sheet as of January 2, 2009.

The Company is required, under certain circumstances as defined in the Credit Facility, to use a percentage of cash generated from operations to reduce the outstanding principal of the Term Loan Facility in the year after the excess cash flow is generated. The actual amount of the required repayment if any, in respect to fiscal year 2009, could vary significantly based on such factors as the timing of cash receipts and cash payments near fiscal year end. Because of this, the Company cannot make a reasonable estimate of the required repayment if any, in respect to fiscal year 2009. In the event a repayment is required to be made, which would be paid during the first quarter of fiscal year 2010, the Company anticipates utilizing borrowings under the Revolving Facility to make such payment.

On July 28, 2008, upon entering in to the Credit Facility, the Company's pre-existing Senior Secured Credit Facility was extinguished. Deferred financing fees totaling \$4.4 million were expensed in the current reporting period. Deferred financing fees associated with the Credit Facility totaling \$5.0 million were recorded in other assets on the Company's consolidated balance sheet.

***9.5% Senior Subordinated Notes***

In February 2005, the Company completed an offering of \$320.0 million in aggregate principal amount of its 9.5% senior subordinated notes due 2013. Interest is payable semi-annually on February 15 and August 15 of each year. Proceeds from the original issuance of the senior subordinated notes, net of fees, were \$310.0 million and were used to pay the consideration for, and fees and expenses relating to our 2005 formation as an independent company from Computer Science Corporation. The senior subordinated notes are general unsecured obligations of the Company's subsidiary, DynCorp International LLC, and certain guarantor subsidiaries of DynCorp International LLC.

In July 2008, the Company completed an offering in a private placement pursuant to Rule 144A under the Securities Act of 1933, as amended, of \$125.0 million in aggregate principal amount of additional 9.5% senior subordinated notes under the same indenture as the senior subordinated notes issued in February 2005. Net proceeds from the additional offering of senior subordinated notes were used to refinance the then existing Senior Secured Credit Facility, to pay related fees and expenses and for general corporate purposes. The additional senior subordinated notes mature on February 15, 2013. The additional senior subordinated notes were issued at approximately a 1.0% discount totaling \$1.2 million. Deferred financing fees associated with this offering totaled \$4.6 million. The Company's registration statement with respect to these notes was declared effective on January 13, 2009. The Company has launched an exchange offer for the notes that is expected to end on or about February 11, 2009.

Prior to February 15, 2009, the Company may redeem the senior subordinated notes, in whole or in part, at a price equal to 100% of the principal amount of the senior subordinated notes plus a defined make-whole premium, plus accrued interest to the redemption date. After February 15, 2009, the Company can redeem the senior subordinated notes, in whole or in part, at defined redemption prices, plus accrued interest to the redemption date. While the Company is restricted under the terms of Credit Facility from redeeming the senior subordinated notes, the holders of the senior subordinated notes may require the Company to repurchase the senior subordinated notes at defined prices in the event of certain specified triggering events, including but not limited to certain asset sales, change-of-control events, and debt covenant violations.



**Table of Contents**

The fair value of the senior subordinated notes is based on their quoted market value. As of January 2, 2009, the quoted market value of the senior subordinated notes was approximately 87% of stated value.

**Note 6 Commitments and Contingencies**

***Commitments***

The Company has operating leases for the use of real estate and certain property and equipment, which are either non-cancelable, cancelable only by the payment of penalties or cancelable upon one month's notice. All lease payments are based on the lapse of time but include, in some cases, payments for insurance, maintenance and property taxes. There are no purchase options on operating leases at favorable terms, but most leases have one or more renewal options. Certain leases on real estate are subject to annual escalations for increases in base rents, utilities and property taxes. Lease rental expense amounted to \$15.1 million and \$14.6 million for the three months ended January 2, 2009 and December 28, 2007, respectively, and \$38.8 million and \$39.3 million for the nine months ended January 2, 2009 and December 28, 2007, respectively.

***Contingencies***

***General Legal Matters***

The Company and its subsidiaries and affiliates are involved in various lawsuits and claims that have arisen in the normal course of business. In most cases, the Company has denied, or believes it has a basis to deny any liability. Related to these matters, the Company has recorded a reserve of approximately \$18.5 million for pending litigation and claims. While it is not possible to predict with certainty the outcome of litigation and other matters discussed below, it is the opinion of the Company's management that recorded reserves are sufficient to cover known matters based on information available as of this Quarterly Report.

***Pending Litigation and Claims***

On May 14, 2008 a jury in the Eastern District of Virginia found against the Company in a case brought by a former subcontractor, Worldwide Network Services ( WWNS ), on two State Department contracts, in which WWNS alleged racial discrimination, tortious interference and certain other claims. The jury awarded WWNS approximately \$15.7 million in compensatory and punitive damages and awarded the Company approximately \$200,000 on a counterclaim. In addition to the jury award, the court awarded WWNS approximately \$3.0 million in connection with certain contract claims. On September 22, 2008, WWNS was awarded approximately \$1.8 million in attorneys' fees. On February 2, 2009, the Company filed an appeal with respect to this matter. As of January 2, 2009, the Company believes it has adequate reserves recorded for this matter.

On April 24, 2007, March 14, 2007, December 29, 2006 and December 4, 2006, four lawsuits were served, seeking unspecified monetary damages against DynCorp International LLC and several of its former affiliates in the U.S. District Court for the Southern District of Florida, concerning the spraying of narcotic plant crops along the Colombian border adjacent to Ecuador. Three of the lawsuits, filed on behalf of the Provinces of Esmeraldas, Sucumbíos, and Carchi in Ecuador, allege violations of Ecuadorian law, international law, and statutory and common tort law violations, including negligence, trespass, and nuisance. The fourth lawsuit, filed on behalf of citizens of the Ecuadorian provinces of Esmeraldas and Sucumbíos, alleges personal injury, various counts of negligence, trespass, battery, assault, intentional infliction of emotional distress, violations of the Alien Tort Claims Act, and various violations of international law. The four lawsuits were consolidated, and based on the Company's motion granted by the court, the case was subsequently transferred to the U.S. District Court for the District of Columbia. On March 26, 2008, a First Amended Consolidated Complaint was filed that identified 3,266 individual plaintiffs. The amended complaint does not demand any specific monetary damages; however, a court decision against the Company, although believed by the Company to be remote, could have a material adverse effect on its results of operations and financial condition. The aerial spraying operations were and continue to be managed by the Company under a Department of State ( DoS ) contract in cooperation with the Colombian government. The DoS contract provides indemnification to the Company against third-party liabilities arising out of the contract, subject to available funding. The DoS has reimbursed the Company for all legal expenses to date.





**Table of Contents**

A lawsuit filed on September 11, 2001, and amended on March 24, 2008, seeking unspecified damages on behalf of twenty-six residents of the Sucumbíos Province in Ecuador, was brought against the Company and several of its former affiliates in the U.S. District Court for the District of Columbia. The action alleges violations of the laws of nations and United States treaties, negligence, emotional distress, nuisance, battery, trespass, strict liability, and medical monitoring arising from the spraying of herbicides near the Ecuador-Colombia border in connection with the performance of the DoS, International Narcotics and Law Enforcement contract for the eradication of narcotic plant crops in Colombia. The terms of the DoS contract provide that the DoS will indemnify DynCorp International LLC against third-party liabilities arising out of the contract, subject to available funding. The DoS has reimbursed the Company for all legal expenses to date. The Company is also entitled to indemnification by Computer Sciences Corporation in connection with this lawsuit, subject to certain limitations. Additionally, any damage award would have to be apportioned between the other defendants and the Company. The Company believes that the likelihood of an unfavorable judgment in this matter is remote and that, even if that were to occur, the judgment is unlikely to result in a material adverse effect on the results of operations or financial condition of the Company as a result of the third party indemnification and apportionment of damages described above.

Arising out of the litigation described in the preceding two paragraphs, the Company filed a separate lawsuit against the Company's aviation insurance carriers seeking defense and coverage of the referenced claims. The carriers filed a lawsuit against the Company on February 5, 2009 seeking rescission of certain aviation insurance policies based on an alleged misrepresentation by the Company concerning the existence of certain of the lawsuits relating to the eradication of narcotic plant crops.

On May 29, 2003, Gloria Longest, a former accounting manager for the Company, filed suit against DynCorp International LLC and a subsidiary of Computer Sciences Corporation under the False Claims Act and the Florida Whistleblower Statute, alleging that the defendants submitted false claims to the U.S. government under the International Narcotics & Law Enforcement contract with the DoS. The U.S. Department of Justice approved the terms of the confidential settlement between the parties and the court entered an order of dismissal on September 26, 2008. The terms of the settlement did not have a material adverse effect on the Company's results of operations or financial condition.

*U.S. Government Investigations*

We also are occasionally the subject of investigations by various agencies of the U.S. government. Such investigations, whether related to our U.S. government contracts or conducted for other reasons, could result in administrative, civil or criminal liabilities, including repayments, fines or penalties being imposed upon us, or could lead to suspension or debarment from future U.S. government contracting.

On January 30, 2007, the Special Inspector General for Iraq Reconstruction ( SIGIR ) issued a report on one of our task orders concerning the Iraqi Police Training Program. Among other items, the report raises questions about our work to establish a residential camp in Baghdad to house training personnel. Specifically, the SIGIR report recommends that the DoS seek reimbursement from us of \$4.2 million paid by the DoS for work that the SIGIR maintains was not contractually authorized. In addition, the SIGIR report recommends that the DoS request the Defense Contract Audit Agency ( DCAA ) to review two of our invoices totaling \$19.1 million. On June 28, 2007, we received a letter from the DoS contracting officer requesting our repayment of approximately \$4.0 million for work performed under this task order, which the letter claims was unauthorized. We responded to the DoS contracting officer in letters dated July 7, 2007 and September 4, 2007, explaining that the work for which we were paid by DoS was appropriately performed and denying DoS' request for repayment of approximately \$4.0 million. By letter dated April 30, 2008, the DoS contracting officer responded to our July 7, 2007 and September 4, 2007 correspondence by taking exception to the explanation set forth in our letters and reasserting the DoS' request for a refund of approximately \$4.0 million. On May 8, 2008, we replied to the DoS letter dated April 30, 2008 and provided additional support for our position.

On September 17, 2008, the U.S. Department of State Office of Inspector General ( OIG ) served us with a records subpoena for the production of documents relating to our Civilian Police Program in Iraq. Among other items, the subpoena seeks documents relating to our business dealings with a former subcontractor, Corporate Bank. We are cooperating with the OIG's investigation and, based on information currently known to management, do not believe this matter will have a material adverse effect on our operating performance.



**Table of Contents***U.S. Government Audits*

Our contracts are regularly audited by the DCAA and other government agencies. These agencies review our contract performance, cost structure and compliance with applicable laws, regulations and standards. The DCAA also reviews the adequacy of, and our compliance with, our internal control systems and policies, including our purchasing, property, estimating, compensation and management information systems. Any costs found to be improperly allocated to a specific contract will not be reimbursed. In addition, government contract payments received by us for allowable direct and indirect costs are subject to adjustment after audit by government auditors and repayment to the government if the payments exceed allowable costs as defined in the government contracts.

The Defense Contract Management Agency ( DCMA ) formally notified the Company of non-compliance with Cost Accounting Standard 403, Allocation of Home Office Expenses to Segments, on April 11, 2007. The Company issued a response to the DCMA on April 26, 2007 with a proposed solution to resolve the area of non-compliance, which related to the allocation of corporate general and administrative costs between the Company's divisions. On August 13, 2007, the DCMA notified the Company that additional information would be necessary to justify the proposed solution. The Company issued responses on September 17, 2007 and April 28, 2008 and the matter is pending resolution. In management's opinion and based on facts currently known, the above-described matters will not have a material adverse effect on the Company's results of operations or financial condition.

The Company, currently, is under audit by the Internal Revenue Service ( IRS ) for employment taxes covering the calendar years 2005 through 2007. In the course of the audit process, the IRS has questioned the Company's treatment of exempting from U.S. employment taxes all U.S. residents working abroad for a foreign subsidiary. While the Company believes its treatment with respect to employment taxes, for these employees, was appropriate, a negative outcome on this matter could result in a potential liability, including penalties, of approximately \$113.8 million related to these calendar years.

*Contract Matters*

During the first fiscal quarter we terminated for cause a contract to build the Akwa Ibom International Airport for the State of Akwa Ibom in Nigeria. Consequently, we terminated certain subcontracts and purchase orders the customer advised us it did not want to assume. Based on our experience with this particular Nigerian state government customer, we believe it likely the customer will challenge our termination of the contract for cause and initiate legal action against us. Our termination of certain subcontracts not assumed by the customer, including our actions to recover against advance payment and performance guarantees established by the subcontractors for our benefit, is being challenged in certain instances.

**Note 7 Income Taxes**

The provision for income taxes consists of the following:

<i>(Amounts in thousands)</i>	<b>Three Months Ended</b>	
	<b>January 2, 2009</b>	<b>December 28, 2007</b>
Current portion:		
Federal	\$ (27,825)	\$ 1,752
State	(1,397)	222
Foreign	1,046	973
Total current portion of tax provision	(28,176)	2,947
Deferred portion:		
Federal	38,586	3,872
State	1,290	149
Foreign	(61)	

Total deferred portion of tax provision	39,815	4,021
Total income tax provision	\$ 11,639	\$ 6,968

**Table of Contents**

<i>(Amounts in thousands)</i>	<b>Nine Months Ended</b>	
	<b>January 2, 2009</b>	<b>December 28, 2007</b>
Current portion:		
Federal	\$ (7,217)	\$ 16,896
State	253	1,124
Foreign	4,857	3,045
Total current portion of tax provision	(2,107)	21,065
Deferred portion:		
Federal	31,218	819
State	1,044	(33)
Foreign	(69)	65
Total deferred portion of tax provision	32,193	851
Total income tax provision	\$ 30,086	\$ 21,916

Deferred tax assets and liabilities are reported as:

<i>(Amounts in thousands)</i>	<b>January 2, 2009</b>	<b>March 28, 2008</b>
	Current deferred tax assets (liabilities)	\$ (1,927)
Non-current deferred tax assets (liabilities)	5,773	18,168
Deferred tax assets, net	\$ 3,846	\$ 35,509

As of January 2, 2009 and March 28, 2008, we have \$4.0 million and \$2.7 million, respectively, of total unrecognized tax benefits. The amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate was \$1.3 million and \$1.2 million for January 2, 2009 and March 28, 2008, respectively.

It is reasonably possible that in the next 12 months the gross amount of unrecognized tax benefits will decrease by \$2.2 million due to settlements with taxing authorities. However, the Company does not expect any material changes to its effective tax rate as a result of such settlements.

The Company recognizes interest accrued related to uncertain tax positions in interest expense and penalties in income tax expense in its unaudited Condensed Consolidated Statements of Income, which is consistent with the recognition of these items in prior periods. The Company has recorded a liability of approximately \$0.8 million and \$0.6 million for the payment of interest and penalties as of January 2, 2009 and March 28, 2008, respectively.

The Company and its subsidiaries file income tax returns in U.S. federal and state jurisdictions and in various foreign jurisdictions. The Company currently is under audit by the Internal Revenue Service for fiscal years 2005 through 2007. In addition, the statute of limitations is open for federal and state examinations for the Company's fiscal year 2005 forward and, with few exceptions, foreign income tax examinations for the calendar year 2004 forward.

For the three and nine months ended January 2, 2009, the Company's effective tax rate was 31.1% and 31.4%, respectively, as compared to 36.8% and 36.5% for the respective three and nine months ended December 28, 2007. The reduction in the effective tax rate was primarily due to the impact of GLS and DIFZ, which are consolidated joint ventures for financial reporting purposes but are unconsolidated entities for U.S. income tax purposes.

During the third quarter of fiscal year 2009, the Company filed an Application for Change in Accounting Method ( CIAM ) with the IRS on form 3115. The application was for a change in the tax accounting method that the Company uses to recognize income with respect to unbilled receivables. Prior to the method change request, the Company's tax accounting method generally followed the financial accounting treatment which recognizes income on unbilled receivables under the percentage of completion method, with the exception of award fees which for tax purposes were not recognized until they became billable. If accepted by the IRS, the CIAM will allow the Company to defer, for tax purposes, the financial reported income on unbilled receivables until such receivables become fixed and determined for tax purposes. The Company has recorded the amount believed to be more-likely-than-not as of January 2, 2009.

**Table of Contents****Note 8 Shareholders Equity**

**Shareholders Equity** The following table presents the changes to shareholders equity during the nine months ended January 2, 2009:

	Common Stock		Additional Paid-In	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total Shareholders Equity
(Amounts in thousands)	Shares	Amount	Capital			
Balance at March 28, 2008	57,000	\$ 570	\$ 357,026	\$ 73,603	\$ (6,914)	\$ 424,285
Comprehensive income:						
Net income				50,604		50,604
Interest rate swap, net of tax \$1.0 million					1,710	1,710
Currency translation adjustment, net of tax \$0.4 million					(634)	(634)
Comprehensive income				50,604	1,076	51,680
Equity-based compensation Tax benefit/(liability) associated with equity-based compensation			575 (10)			575 (10)
Sale of non-controlling interest of DIFZ			8,190			8,190
DIFZ financing, net of tax			106			106
Balance at January 2, 2009	57,000	\$ 570	\$ 365,887	\$ 124,207	\$ (5,838)	\$ 484,826

As described in Note 1, on July 31, 2008, the Company sold 50% of its ownership interest in DIFZ for approximately \$8.2 million. No gain has been recognized on the sale as of January 2, 2009, as the Company completely financed the transaction by accepting three promissory notes provided by the purchaser. As a result, the sale was accounted for as a capital transaction reflected in APIC. Additionally, the interest component of the three notes receivable held by the Company is also reflected in APIC, shown above as DIFZ financing, and has not impacted the Company's consolidated statements of income as of January 2, 2009.

**Common Stock Repurchase** The Board of Directors of the Company (the Board) has authorized the Company to repurchase up to \$25.0 million of its outstanding common stock. The shares may be repurchased from time to time in open market conditions or through privately negotiated transactions at the Company's discretion, subject to market conditions, and in accordance with applicable federal and state securities laws and regulations. Shares of common stock repurchased under this plan will be held as treasury shares. The share repurchase program does not obligate the Company to acquire any particular amount of common stock and may be modified or suspended at any time at the Company's discretion. The purchases will be funded from available working capital. No shares have been repurchased under this program through January 2, 2009.

**Note 9 Equity-Based Compensation**

As of January 2, 2009, the Company had provided equity-based compensation through the grant of Class B interests in DIV Holding LLC, the majority holder of the Company's common stock and the grant of Restricted Stock Units (RSUs) under the Company's 2007 Omnibus Incentive Plan (the 2007 Plan). All of the Company's equity-based



compensation is accounted for under SFAS No. 123(R), Share-Based Payment . Under this method, the Company recorded equity-based compensation expense of \$1.2 million and \$1.1 million for the three months ended January 2, 2009 and December 28, 2007, respectively, and \$2.4 million and \$3.4 million for the nine months ended January 2, 2009 and December 28, 2007, respectively.

**Table of Contents***Class B Interests*

During the first quarter of fiscal year 2009, the Company's former CEO, Herbert J. Lanese, was terminated without cause in accordance with the conditions of his employment agreement, which resulted in the forfeiture of his unvested Class B interests in DIV Holding LLC granted to him as an employee of the Company. Mr. Lanese was subsequently issued additional Class B interests for his continued service on the Board. In addition, his separation resulted in severance liabilities of approximately \$4.1 million recorded in the first fiscal quarter of 2009, which will be paid in installments over the twelve months following the date of his termination.

During the third quarter of fiscal year 2009, the Company's former Executive Vice President, General Anthony Zinni (USMC Ret.), resigned which resulted in the forfeiture of his unvested Class B interests in DIV Holding LLC granted to him as an employee of the Company.

A summary of Class B interest activity during fiscal year 2009 is as follows:

<i>(Dollar amounts in thousands)</i>	<b>% Interest in DIV Holding</b>	<b>Grant Date Fair Value</b>
<b>Balance March 28, 2008</b>	6.24%	\$ 13,248
First Quarter Fiscal Year 2009 Grants	0.20%	867
First Quarter Fiscal Year 2009 Forfeitures	(1.20%)	(2,530)
<b>Balance July 4, 2008</b>	5.24%	\$ 11,585
Second Quarter Fiscal Year 2009 Grants	0.00%	
Second Quarter Fiscal Year 2009 Forfeitures	0.00%	
<b>Balance October 3, 2008</b>	5.24%	\$ 11,585
Third Quarter Fiscal Year 2009 Grants	0.00%	
Third Quarter Fiscal Year 2009 Forfeitures	(0.01%)	(73)
<b>Balance January 2, 2009</b>	5.23%	\$ 11,512
<b>March 28, 2008 Vested</b>	2.82%	\$ 4,641
First Quarter Fiscal Year 2009 Vesting	0.12%	520
<b>July 4, 2008 Vested</b>	2.94%	5,161
Second Quarter Fiscal Year 2009 Vesting	0.05%	73
<b>October 3, 2008 Vested</b>	2.99%	5,234
Third Quarter Fiscal Year 2009 Vesting	0.34%	1,282
<b>January 2, 2009 Vested</b>	3.33%	\$ 6,516
<b>March 28, 2008 Nonvested</b>	3.42%	\$ 8,607
<b>January 2, 2009 Nonvested</b>	1.90%	\$ 4,996
Assuming each grant outstanding, net of estimated forfeitures, as of January 2, 2009 fully vests, the Company will recognize the related non-cash compensation expense as follows (amounts in thousands):		
Three month period ended April 3, 2009	\$	369

Edgar Filing: DYNCORP INTERNATIONAL INC. - Form 10-Q

Fiscal year ended April 2, 2010	1,139
Fiscal year ended April 1, 2011 and thereafter	566
Total	\$ 2,074

**Table of Contents***Restricted Stock Units*

During the first nine months of fiscal year 2009, the Company awarded service-based and performance-based RSUs to certain key employees ( Participants ). The grants were made pursuant to the terms and conditions of the 2007 Plan and are subject to award agreements between the Company and each Participant.

During the first nine months of fiscal year 2009, 186,800 performance-based RSUs were granted to certain key employees. These performance-based awards are tied to the Company's financial performance, specifically fiscal year 2011 EBITDA (earnings before interest, taxes, depreciation and amortization), and cliff vest upon achievement of this target. Based on current estimates, the costs of these awards are being accrued with the expectation of a 100% achievement of the performance goal.

In addition to employee grants, 22,425 service-based RSUs were granted to Board members. These awards vest within one year of grant, but include a post-vesting restriction of six months after the applicable directors' Board service ends. The RSUs have assigned value equivalent to the Company's common stock and may be settled in cash or shares of the Company's common stock at the discretion of the Compensation Committee of the Board.

As of January 2, 2009, 100,000 RSUs have been awarded to our current CEO. Half of these awards are service-based and vest ratably over a three year period on the anniversary of the CEO's employment commencement date. The remaining 50,000 RSUs are performance-based and are tied to specific performance goals for fiscal year 2009. If the performance measures are achieved for fiscal year 2009, the awards will vest over a three-year service period with one third vesting each year on the anniversary of the CEO's employment commencement date. Based on current estimates, the costs of these awards are being accrued with the expectation of a 100% achievement of the performance goal.

The RSUs have been determined to be liability awards; therefore, the fair value of the RSUs are re-measured at each financial reporting date as long as they remain liability awards. The estimated fair value of all RSUs net of estimated forfeitures, based on the closing market price of the Company's stock on the grant date of each respective award, was approximately \$6.1 million, based on the closing market price of the Company's stock on January 2, 2009. During the nine months ended January 2, 2009, 53,250 RSU awards vested and 52,250 of these awards were subsequently settled for \$0.8 million in cash.

A summary of RSU activity during the nine months ended January 2, 2009 is as follows:

	<b>Outstanding Restricted Stock Units</b>	<b>Weighted Average Grant Date Fair Value</b>
Outstanding, March 28, 2008	159,600	\$ 21.49
Units granted	309,225	15.54
Units cancelled	(32,350)	20.25
Units vested and settled	(52,250)	21.19
Outstanding, January 2, 2009 <sup>(1)</sup>	384,225	\$ 16.85

(1) Total outstanding includes 1,000 RSUs vested and unsettled as of January 2, 2009.

Assuming each grant outstanding as of January 2, 2009, net of estimated forfeitures, fully vests (assuming 100% for performance-based awards), the Company will recognize the related equity-based compensation expense as follows based on the value of these liability awards as of January 2, 2009 (amounts in thousands):

Edgar Filing: DYNCORP INTERNATIONAL INC. - Form 10-Q

Three month period ended April 3, 2009	\$	614
Fiscal year ended April 2, 2010		2,180
Fiscal year ended April 1, 2011 and thereafter		1,718
Total	\$	4,512

**Table of Contents****Note 10 Interest Rate Derivatives**

At January 2, 2009, the Company's derivative instruments consisted of two interest rate swap agreements, designated as cash flow hedges, that effectively fix the interest rate on the applicable notional amounts of the Company's variable rate debt as follows (dollar amounts in thousands):

<b>Date Entered</b>	<b>Notional Amount</b>	<b>Fixed Interest Rate Paid<sup>(1)</sup></b>	<b>Variable Interest Rate Received</b>	<b>Expiration Date</b>
April 2007	\$ 168,620	4.975%	3-month LIBOR	May 2010
April 2007	\$ 31,380	4.975%	3-month LIBOR	May 2010

(1) Plus applicable margin (2.5% at January 2, 2009).

The fair value of the interest rate swap agreements was a liability of \$8.7 million at January 2, 2009, of which \$2.9 million was considered long term. Unrealized net loss from the changes in fair value of the interest rate swap agreements of \$1.7 million, net of tax, for the nine months ended January 2, 2009 is included in other comprehensive income (loss). There was no material impact on earnings due to hedge ineffectiveness for the three and nine months ended January 2, 2009.

**Note 11 Composition of Certain Financial Statement Captions**

The following tables present financial information of certain consolidated balance sheet captions.

*Prepaid expense and other current assets* Prepaid expense and other current assets were:

<i>(Amounts in thousands)</i>	<b>January 2, 2009</b>	<b>March 28, 2008</b>
Prepaid expenses	\$ 40,160	\$ 43,205
Inventories	9,927	8,463
Work-in-process inventories	38,570	45,245
Minority interest		3,306
Income taxes receivable	19,203	
Joint venture receivables	8,878	2,076
Other current assets	9,018	6,732
	\$ 125,756	\$ 109,027

Prepaid expenses include prepaid insurance, prepaid vendor deposits, and prepaid rent, none of which individually exceed 5% of current assets. As of March 28, 2008, the minority interest resulted in a net debit balance due to the accumulated net loss in GLS.

*Accrued payroll and employee costs* Accrued payroll and employee costs were:

<i>(Amounts in thousands)</i>	<b>January 2, 2009</b>	<b>March 28, 2008</b>
Wages, compensation and other benefits	\$ 82,621	\$ 57,940

Accrued vacation	26,037	24,760
Accrued contributions to employee benefit plans	2,921	2,486
	\$ 111,579	\$ 85,186

*Other accrued liabilities* Other accrued liabilities were:

<i>(Amounts in thousands)</i>	<b>January 2, 2009</b>	<b>March 28, 2008</b>
Deferred revenue	\$ 31,308	\$ 53,083
Accrued insurance	24,539	36,260
Accrued interest	15,888	9,885
Contract losses and customer liabilities	12,793	134
Legal matters	18,478	19,851
Short-term swap liability	5,787	5,783
Other notes payable	4,674	374
Other	8,115	3,870
	\$ 121,582	\$ 129,240

**Table of Contents**

Deferred revenue is primarily due to payments in excess of services provided for certain contracts in addition to payments received for services that must be deferred as a result of multiple element arrangements being recorded as a single unit of accounting. Included in the contract losses and customer liabilities balance is \$10.1 million of estimated future losses associated with an Afghanistan construction project.

**Note 12 Fair Value of Financial Assets and Liabilities**

Effective March 29, 2008, the Company adopted SFAS No. 157. In February 2008, the FASB issued FASB Staff Position No. 157-2, Effective Date of FASB Statement No. 157, which provides a one year deferral of the effective date of SFAS No. 157 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. Therefore, the Company has adopted the provisions of SFAS No. 157 with respect to its financial assets and liabilities only. Although the adoption of SFAS No. 157 did not materially impact the Company's financial condition, results of operations, or cash flow, the Company is required to provide additional disclosures as part of its financial statements.

SFAS No. 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include:

Level 1, defined as observable inputs such as quoted prices in active markets;

Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and

Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

As of January 2, 2009, the Company held certain assets and had incurred certain liabilities that are required to be measured at fair value on a recurring basis. These included cash equivalents (including restricted cash) and interest rate derivatives. Cash equivalents consist of petty cash, cash in-bank and short-term, highly liquid, income-producing investments with original maturities of 90 days or less. The Company's interest rate derivatives, as further described in Note 10, consist of interest rate swap contracts. The fair values of the interest rate swap contracts are determined based on inputs that are readily available in public markets or can be derived from information available in publicly quoted markets. Therefore, the Company has categorized these interest rate swap contracts as Level 2. The Company has consistently applied these valuation techniques in all periods presented.

The Company's assets and liabilities measured at fair value on a recurring basis subject to the disclosure requirements of SFAS 157 at January 2, 2009, were as follows:

**Fair Value Measurements at Reporting Date Using**

	Book value of financial assets/(liabilities) as of January 2, 2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(amounts in thousands)				
<b>Assets</b>				
Cash equivalents <sup>(1)</sup>	\$ 168,619	\$ 168,619	\$	\$
Total assets measured at fair value	\$ 168,619	\$ 168,619	\$	\$
<b>Liabilities</b>				
Interest rate derivatives	\$ 8,727	\$	\$ 8,727	\$



Total liabilities measured at fair value	\$	8,727	\$	\$	8,727	\$
--	----	-------	----	----	-------	----

(1) Includes cash and cash equivalents and restricted cash.

**Table of Contents**

**Note 13 Joint Ventures and Related Parties**

Amounts due from the Company's unconsolidated joint ventures totaled \$8.9 million and \$2.1 million as of January 2, 2009 and March 28, 2008, respectively. These receivables are a result of items purchased and services rendered by the Company on behalf of the Company's unconsolidated joint ventures. The Company has assessed these receivables as having minimal collection risk based on the historic experience with these joint ventures and the Company's inherent influence through its ownership interest. The change in these receivables from March 28, 2008 to January 2, 2009 resulted in a use of operating cash for the nine months ended January 2, 2009 of \$6.8 million. The related revenue associated with the Company's unconsolidated joint ventures totaled \$2.1 million and \$16.1 million for the three and nine months ended January 2, 2009, respectively, and \$3.2 million and \$5.1 million for the three and nine months ended December 28, 2007.

As discussed in Note 1, the Company sold half of its previously wholly owned subsidiary, DIFZ, on July 31, 2008 to Palm Trading Investment Corp. ( Palm ). DIFZ provides leased contract employees, back office staff and outsourced payroll and human resource support services through its approximately 4,100 employees. Currently, all DIFZ revenue and costs are eliminated through the Company's consolidation process.

As a result of the DIFZ sale, the Company currently holds three promissory notes from Palm for the purchase price which totaled \$8.2 million. The notes are included in Prepaid expenses and other assets and in Other assets on our consolidated balance sheet for the short and long term portions, respectively. As of January 2, 2009, the loan balance outstanding with Palm was \$8.3 million, including accrued interest of \$0.1 million. As indicated in Note 8, accrued interest is recorded in APIC.

**Note 14 Segment Information**

On April 1, 2008, the Company announced it would change from reporting financial results on two segments, GS and MTSS, to reporting three segments, beginning with the first fiscal quarter of 2009. This was accomplished by splitting GS into two distinct reporting segments.

The three segments are as follows:

International Security Services, or ISS segment, which consists of the Law Enforcement and Security, or LES, business unit, the Specialty Aviation and Counter Drug , or SACD, business unit, and Global Linguist Solutions, or GLS.

Logistics and Construction Management, or LCM segment, and is comprised of the Contingency and Logistics Operations, or CLO, business unit and the Operations, Maintenance, and Construction Management, or OMCM, business unit. This segment is also responsible for winning and performing new work on our LOGCAP IV contract.

Maintenance and Technical Support Services, or MTSS segment, consists of its original components and DynMarine Services, which was previously reported under the GS segment.

**Table of Contents**

The following is a summary of the financial information of the reportable segments reconciled to the amounts reported in the condensed consolidated financial statements. All prior periods presented have been recast to reflect the new segment reporting.

<i>(Amounts in thousands)</i>	<b>Three Months Ended</b>	
	<b>January 2, 2009</b>	<b>December 28, 2007</b>
<b>Revenue</b>		
International Security Services	\$ 465,757	\$ 265,722
Logistics and Construction Management	90,423	73,064
Maintenance and Technical Support Services	237,842	184,285
Other/elimination	(1,695)	
Total revenue	\$ 792,327	\$ 523,071
<b>Operating Income</b>		
International Security Services	\$ 33,167	\$ 20,576
Logistics and Construction Management	536	5,016
Maintenance and Technical Support Services	17,880	5,233
Total operating income	\$ 51,583	\$ 30,825
<b>Depreciation and amortization</b>		
International Security Services	\$ 6,671	\$ 7,153
Logistics and Construction Management	675	804
Maintenance and Technical Support Services	2,683	2,953
Total depreciation and amortization	\$ 10,029	\$ 10,910
	<b>Nine Months Ended</b>	
<i>(Amounts in thousands)</i>	<b>January 2, 2009</b>	<b>December 28, 2007</b>
<b>Revenue</b>		
International Security Services	\$ 1,343,467	\$ 825,134
Logistics and Construction Management	269,351	183,815
Maintenance and Technical Support Services	679,449	557,904
Other/elimination	(3,995)	
Total revenue	\$ 2,288,272	\$ 1,566,853
<b>Operating Income</b>		
International Security Services	\$ 108,545	\$ 78,069
Logistics and Construction Management	(16,451)	4,674
Maintenance and Technical Support Services	46,116	14,231
Total operating income	\$ 138,210	\$ 96,974
<b>Depreciation and amortization</b>		
International Security Services	\$ 20,297	\$ 21,198

Logistics and Construction Management	2,144	2,102
Maintenance and Technical Support Services	8,153	8,601
Total depreciation and amortization	\$ 30,594	\$ 31,901

<i>(Amounts in thousands)</i>	<b>As of</b>	
	<b>January 2, 2009</b>	<b>March 28, 2008</b>
<b>Assets</b>		
International Security Services	\$ 795,198	\$ 725,775
Logistics and Construction Management	204,975	199,088
Maintenance and Technical Support Services	342,431	336,721
Corporate/other <sup>(1)</sup>	231,645	141,125
Total assets	\$ 1,574,249	\$ 1,402,709

(1) Assets primarily include cash, deferred income taxes, and deferred debt issuance cost.

**Table of Contents**

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

The following discussion and analysis of our consolidated financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements, and the notes thereto, and other data contained elsewhere in this Quarterly Report. The following discussion and analysis should also be read in conjunction with our audited consolidated financial statements, and notes thereto, and Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K filed with the SEC on June 10, 2008. References herein to DynCorp International, the Company, we, our, or us refer to DynCorp International and its subsidiaries unless otherwise stated or indicated by the context.

**COMPANY OVERVIEW**

We are a leading provider of specialized mission-critical professional and support services outsourced by the U.S. military, non-military U.S. governmental agencies and foreign governments. Our specific global expertise is in law enforcement training and support, security services, base and logistics operations, construction management, aviation services and operations, and linguist services. We also provide logistics support for all our services, through approximately 47 active contracts ranging in duration from three to ten years and over 100 task orders. As of January 2, 2009, we had approximately 21,000 employees in approximately 30 countries. DynCorp International and its predecessors have provided essential services to numerous U.S. government departments and agencies since 1951. We operate our business through three segments: ISS; LCM; and MTTTS. Each of these segments is described below.

**International Security Services**

ISS provides various outsourced services primarily to government agencies worldwide. ISS consists of the following strategic business units:

*Law Enforcement and Security* This operating unit provides international policing and police training, judicial support, immigration support and base operations. In addition, it provides security and personal protection for diplomats.

*Specialty Aviation and Counter-drug Operations* This operating unit's services include drug eradication and host nation pilot and crew training.

*Global Linguist Solutions* This consolidated joint venture between DynCorp International and McNeil Technologies provides rapid recruitment, deployment and on-site management of interpreters and translators in-theatre to the U.S. Army for a wide range of foreign languages.

**Logistics and Construction Management**

LCM provides technical support services to government agencies and commercial customers worldwide. LCM consists of the following strategic business units:

*Contingency and Logistics Operations* This operating unit provides peace-keeping support, humanitarian relief, de-mining, worldwide contingency planning and other rapid response services. In addition, it offers inventory procurement and tracking services, equipment maintenance, property control, data entry and mobile repair services.

## **Table of Contents**

*Operations Maintenance and Construction Management* This operating unit provides facility and equipment maintenance and control, custodial and administrative services. In addition, it provides civil, electrical, infrastructure, environmental and mechanical engineering and construction management services.

### **Maintenance and Technical Support Services**

MTSS provides a wide range of technical, engineering, logistics and maintenance support services primarily to government agencies worldwide. MTSS consists of the following strategic business areas:

*Contract Logistics Support* Provides worldwide support of U.S. Army, Air Force and Navy fixed wing assets. Aircraft are deployed throughout the U.S., Europe, Asia, South America and the Middle East. Contract Logistics Support ( CLS ) provides flight line and depot level maintenance, consisting of scheduled and unscheduled events. Specific functions include repair, overhaul and procurement of components, procurement of consumable materials and transportation of materials to and from the operating sites. In addition, the team is responsible for obsolescence engineering, quality control, inventory management, avionics upgrades and recovery of downed aircraft.

*Field Service Operations* Provides worldwide maintenance, modification, repair and logistics support on aircraft, weapons systems, and related support equipment to the Department of Defense ( DoD ) and other U.S. government agencies. Contract Field Teams ( CFT ) is the most significant program in our Field Service Operations SBA. Our company and its predecessors have provided CFT service for over 55 consecutive years. This program deploys highly mobile, quick-response field teams to customer locations to supplement a customer's workforce.

*Aviation and Maintenance Services* Provides aircraft fleet maintenance and modification services, ground vehicle maintenance and modification services, marine services, pilot and maintenance training, logistics support, air traffic control services, base and depot operations, program management and engineering services. These services are offered on a domestic and international basis.

## **CURRENT OPERATING CONDITIONS AND OUTLOOK**

### *External Factors*

Over most of the last two decades, the U.S. government has been increasing its reliance on the private sector for a wide range of professional and support services. This increased use of outsourcing by the U.S. government has been driven by a variety of factors, including: lean-government initiatives launched in the 1990s; surges in demand during times of national crisis; the increased complexity of missions conducted by the U.S. military and the Department of State ( DoS ); the increased focus of the U.S. military on war-fighting efforts; and the loss of skills within the government caused by workforce reductions and retirements. These factors lead us to believe that the U.S. government's growing mission and continued human capital challenges have combined to create a new market dynamic, one that is less directly reflective of overall government budgets and more reflective of the ongoing shift of service delivery from the federal workforce to competent, efficient private sector providers.

We believe the following industry trends will result in continued strong demand in our target markets for the types of outsourced services that we provide:

The continued transformation of military forces, leading to increased outsourcing of non-combat functions, including life-cycle asset management functions ranging from organizational to depot level maintenance;

An increase in the level and frequency of overseas deployments and peace-keeping operations for the DoS, DoD and United Nations;

Increased maintenance, overhaul and upgrade needs to support aging military platforms;

Increased outsourcing by foreign militaries of maintenance, supply support, facilities management, training and construction management-related services; and

The shift from single award to more multiple award indefinite delivery, indefinite quantity ( IDIQ ) contracts, which may offer us an opportunity to increase revenue under these contracts by competing for task orders with the other contract awardees.



**Table of Contents**

We believe that the cost of current and proposed economic stimulus packages and other initiatives undertaken by the Federal government in connection with the current economic crisis will likely have an eventual negative impact on the defense budget. We believe, however, that within the defense budget, weapon system acquisitions will be the most likely initial target for budget reductions, and operations and maintenance budgets will remain robust, driven by (i) the need to reset equipment coming out of Iraq, (ii) the logistics and support chain associated with repositioning of forces and eventual draw down in Iraq and (iii) deployments into Afghanistan.

Initial statements from the new Obama administration indicate that the President will seek to withdraw troops from Iraq, specifically U.S. combat forces by as early as mid-2010. The new administration also has indicated that it will support an expanded presence in Afghanistan of additional U.S. troops. Based on the foregoing, we expect our level of business involving Iraq to be relatively stable over the next few years, with demand remaining strong for logistics, equipment reset, training and mentoring of Iraqi forces and government agencies and translation services to support security and peacekeeping activities. In Afghanistan, we believe we are well positioned to capitalize on any increased U.S. government focus through many of our service offerings, including police training and mentoring, aircraft logistics and operations, infrastructure development, mine resistant and ambush protected ( MRAP ) services, poppy eradication and logistics services under LOGCAP IV.

*Current Economic Conditions*

We believe that our industry and customer base are less likely to be affected by many of the factors affecting business and consumer spending generally. Accordingly, we believe that we continue to be well positioned in the current economic environment as a result of historic demand factors affecting our industry, the nature of our contracts and our sources of liquidity. However, we cannot be certain that the economic environment or other factors will not adversely impact our business, financial condition or results of operations in the future.

Furthermore, we believe that our current sources of liquidity will enable us to continue to perform under our existing contracts and further grow our business. However, a sustained credit crisis could adversely affect our ability to obtain additional liquidity or refinance existing indebtedness on acceptable terms or at all, which could adversely affect our business, financial condition and results of operations.

See Part II Other Information Item 1A. Risk Factors Current or worsening economic conditions could impact our business.

*Internal Factors*

Our internal focus for success centers around five key principles:

**Performance** Through a relentless mind set in meeting our commitments to our customers every day and in operating with absolute integrity and in accordance with our Code of Ethics and Business Conduct in all that we do.

**Lean Infrastructure** In order to further fuel our growth and invest in our people, we must generate additional investment capacity by ensuring that our infrastructure is as efficient as possible without jeopardizing our ability to perform.

**Strategic Investment** We must have clarity in our strategic priorities, and we must properly focus our investments in people, new program pursuits and efforts to penetrate new segments of the market.



**Table of Contents**

**New Business** Growing our business profitably starts with winning new business. This involves having a winning attitude across our enterprise, particularly in satisfying our customers and competing for business.

**People** We must be the employer of choice, with strong, trusted leadership, an employee-focused environment and a culture of mutual respect in which our employees are empowered and rewarded for serving our customers and ensuring their success.

We apply these key principles continuously as we assess our operational and administrative performance.

**Current Events**

The results of our operations for the three and nine months ended January 2, 2009 exceeded expectations across our core business areas with the exception of our Afghanistan construction contracts, within our LCM segment, which encountered cost overruns due to significant challenges, including the deteriorating security situation. Management has determined that several of our Afghanistan construction contracts will operate at a loss or at margins approaching zero over their contract terms. We do not expect to bid any similar firm fixed price contracts without revised terms and conditions.

See the Results of Operations section below for further information regarding the financial impact of our construction business on our consolidated financial results.

**CONTRACT TYPES**

Our business generally is performed under fixed-price, time-and-materials or cost-reimbursement contracts. Each of these is described below.

*Fixed-Price Type Contracts:* In a fixed-price contract, the price is not subject to adjustment based on costs incurred, which can favorably or adversely impact our profitability depending upon our execution in performing the contracted service. Fixed-price types received by us include firm fixed-price, fixed-price with economic adjustment and fixed-price incentive.

*Time-and-Materials Type Contracts:* A time-and-materials type contract provides for acquiring supplies or services on the basis of direct labor hours at fixed hourly/daily rates plus materials at cost.

*Cost-Reimbursement Type Contracts:* Cost-reimbursement type contracts provide for payment of allowable incurred costs, to the extent prescribed in the contract, plus a fixed-fee, award-fee or incentive-fee.

Award-fees or incentive-fees are generally based upon various objective and subjective criteria, such as aircraft mission capability rates and meeting cost targets.

Our historical contract mix by type, as a percentage of revenue, is indicated in the table below.

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>January 2, 2009</b>	<b>December 28, 2007</b>	<b>January 2, 2009</b>	<b>December 28, 2007</b>
Fixed Price	23.6%	41.2%	27.6%	40.4%
Time-and-Materials	23.1%	32.8%	24.4%	34.5%
Cost-Reimbursement	53.3%	26.0%	48.0%	25.1%
	100%	100%	100%	100%

**Table of Contents****BACKLOG**

We track backlog in order to assess our current business development effectiveness and to assist us in forecasting our future business needs and financial performance. Our backlog consists of funded and unfunded amounts under contracts. Funded backlog is equal to the amounts actually appropriated by a customer for payment of goods and services less actual revenue recognized as of the measurement date under that appropriation. Unfunded backlog is the actual dollar value of unexercised priced contract options.

Most of our U.S. government contracts allow the customer the option to extend the period of performance of a contract for a period of one or more years. These priced options may or may not be exercised at the sole discretion of the customer. Historically, it has been our experience that customers have typically exercised contract options.

Firm funding for our contracts is usually made for one year at a time, with the remainder of the contract period consisting of a series of one-year options. As is the case with the base period of our U.S. government contracts, option periods are subject to the availability of funding for contract performance. The U.S. government is legally prohibited from ordering work under a contract in the absence of funding. Our historical experience has been that the government has typically funded the option periods of our contracts.

The following table sets forth our approximate contracted backlog as of the dates indicated:

<i>(in millions)</i>	<b>January 2, 2009</b>	<b>March 28, 2008</b>
Funded Backlog	\$ 1,485	\$ 1,164
Unfunded Backlog	5,067	4,797
Total Backlog	\$ 6,552	\$ 5,961

Total backlog as of January 2, 2009 was \$6.6 billion, as compared to \$6.0 billion as of March 28, 2008, primarily due to the award of the War Reserve Materiel recompile during the first quarter of the fiscal year. As of January 2, 2009 and March 28, 2008, total backlog related to GLS was \$3.3 billion and \$3.5 billion, respectively, and is incorporated in the table above.

**ESTIMATED REMAINING CONTRACT VALUE**

Our estimated remaining contract value represents total backlog plus management's estimate of future revenue under IDIQ contracts for task or delivery orders that have not been awarded. Future revenue represents management's estimate of revenue that will be recognized from future task or delivery orders through the end of the term and is based on our experience under such IDIQ contracts and management judgments and estimates as to future performance. Although we believe our estimates are reasonable, there can be no assurance that our existing contracts will result in actual revenue in any particular period or at all. Our estimated remaining contract value could vary or even change significantly depending upon various factors, including government policies, government budgets and appropriations, the accuracy of our estimates of work to be performed under time and material contracts and whether we successfully compete with any multiple bidders in IDIQ contracts. The Company's estimated remaining contract value as of January 2, 2009 increased to \$9.7 billion from \$7.5 billion as of March 28, 2008, primarily due to the successful recompile of the Contract Field Teams contract.

**RESULTS OF OPERATIONS**

The Company reports its results on a 52/53-week fiscal year, with the fiscal year ending on the Friday closest to March 31 of such year (April 3, 2009 for fiscal year 2009, which is a 53-week fiscal year). The nine-month fiscal period ended January 2, 2009 was a 40-week period from March 29, 2008 to January 2, 2009. The nine-month fiscal period ended December 28, 2007 was a 39-week period from March 31, 2007 to December 28, 2007.

**Table of Contents***Consolidated*

The following tables set forth, for the periods indicated, our consolidated results of operations, both in dollars and as a percentage of revenue:

<i>(Amounts in thousands)</i>	<b>Three Months Ended</b>			
	<b>January 2, 2009</b>		<b>December 28, 2007</b>	
Revenue	\$ 792,327	100.0%	\$ 523,071	100.0%
Cost of services	(704,210)	(88.9%)	(452,341)	(86.5%)
Selling, general and administrative expenses	(26,505)	(3.3%)	(28,995)	(5.5%)
Depreciation and amortization expense	(10,029)	(1.3%)	(10,910)	(2.1%)
Operating income	51,583	6.5%	30,825	5.9%
Interest expense	(15,322)	(1.9%)	(14,052)	(2.7%)
Loss on early extinguishment of debt		0.0%		0.0%
Earnings from affiliates	1,319	0.2%	1,253	0.2%
Interest income	730	0.1%	522	0.1%
Other income, net	(856)	(0.1%)	380	0.1%
Income before taxes	37,454	4.7%	18,928	3.6%
Provision for income tax (as a percentage of income before tax)	(11,639)	(31.1%)	(6,968)	(36.8%)
Income before minority interest	25,815	3.3%	11,960	2.3%
Minority interest	(6,062)	(0.8%)		0.0%
Net income	\$ 19,753	2.5%	\$ 11,960	2.3%

<i>(Amounts in thousands)</i>	<b>Nine Months Ended</b>			
	<b>January 2, 2009</b>		<b>December 28, 2007</b>	
Revenue	\$ 2,288,272	100.0%	\$ 1,566,853	100.0%
Cost of services	(2,039,118)	(89.1%)	(1,358,062)	(86.7%)
Selling, general and administrative expenses	(80,350)	(3.5%)	(79,916)	(5.1%)
Depreciation and amortization expense	(30,594)	(1.3%)	(31,901)	(2.0%)
Operating income	138,210	6.0%	96,974	6.2%
Interest expense	(44,442)	(1.9%)	(42,247)	(2.7%)
Loss on early extinguishment of debt	(4,443)	(0.2%)		0.0%
Earnings from affiliates	3,959	0.2%	3,320	0.2%
Interest income	1,751	0.1%	2,202	0.1%
Other income, net	809	0.0%	(162)	0.0%
Income before taxes	95,844	4.2%	60,087	3.8%
Provision for income tax (as a percentage of income before tax)	(30,086)	(31.4%)	(21,916)	(36.5%)

Income before minority interest	65,758	2.9%	38,171	2.4%
Minority interest	(15,154)	(0.7%)		0.0%
Net income	\$ 50,604	2.2%	\$ 38,171	2.4%

*Revenue* Revenue for the three and nine months ended January 2, 2009 increased \$269.3 million, or 51.5%, and \$721.4 million, or 46.0%, respectively, as compared with the three and nine months ended December 28, 2007. The increase, as more fully described in the results by segment, is principally due to growth from new contracts such as the Intelligence and Security Command ( INSCOM ) contract.

*Cost of services* Cost of services are comprised of direct labor, direct material, subcontractor costs, other direct costs and overhead. Other direct costs include travel, supplies and other miscellaneous costs. Costs of services for the three and nine months ended January 2, 2009 increased by \$251.9 million, or 55.7% and \$681.1 million, or 50.1%, respectively compared with the three and nine months ended December 28, 2007 and was primarily a result of revenue growth. As a percentage of revenue, costs of services increased to 88.9% and 89.1%, respectively, for the three and nine months ended January 2, 2009 as compared to 86.5% and 86.7%, respectively, for the three and nine months ended December 28, 2007, primarily as a result of a change in contract mix, with the INSCOM contract and changes in portions of the CIVPOL contract increasing our percentage of revenue from cost type contracts. Cost overruns by our Afghanistan construction contracts, as further described below, also contributed to the change.

**Table of Contents**

*Selling, general and administrative expenses ( SG&A )* SG&A primarily relates to functions such as management, legal, finance, accounting, contracts and administration, human resources, management information systems, purchasing and business development. SG&A for the three and nine months ended January 2, 2009 decreased \$2.5 million, or 8.6%, and increased \$0.4 million, or 0.5%, respectively, compared with the three and nine months ended December 28, 2007. SG&A for the three months ended January 2, 2009 decreased primarily as a result of lean infrastructure initiatives focused on controlling SG&A costs. SG&A for the nine months ended January 2, 2009 increased as a result of growth in our underlying business, various initiatives to improve organizational capability and compliance, systems improvements and severance costs, offset in part by implementing lean infrastructure initiatives which controlled SG&A growth relative to revenue growth during the nine months ended January 2, 2009. SG&A as a percentage of revenue decreased to 3.3% and 3.5% for the three and nine months ended January 2, 2009, respectively, compared to 5.5% and 5.1% for the respective three and nine month periods ended December 28, 2007.

*Interest expense* Interest expense for the three and nine months ended January 2, 2009 increased by \$1.3 million, or 9.0%, and \$2.2 million, or 5.2%, respectively, as compared with the three and nine months ended December 28, 2007. The interest expense incurred relates to our Credit Facility, senior subordinated notes and amortization of deferred financing fees. The increase in interest expense is primarily due to a higher average outstanding debt balance and higher average interest rates as a result of our new debt financing. In addition to the change in interest expense, deferred financing fees associated with our prior debt were also written-off as further discussed in Note 5. The impact of this write-off is separately disclosed in our consolidated statements of income.

*Income tax expense* - Our effective tax rate of 31.1% and 31.4% for the three and nine months ended January 2, 2009, respectively, decreased from 36.8% and 36.5% for the respective three and nine months ended December 28, 2007. Our effective tax rate was impacted by the tax treatment of our GLS and DIFZ joint ventures which are not consolidated for tax purposes but rather are taxed as partnerships under the Internal Revenue Code.

*Impact of our Afghanistan Construction Contracts*

For the three and nine months ended January 2, 2009, revenue from our Afghanistan construction contracts was \$15.5 million and \$59.9 million, respectively. There was \$0.2 million of revenue from Afghanistan construction contracts for the three and nine months ended December 28, 2007. Our remaining revenue through completion of these contracts in our third quarter of fiscal year 2010 is expected to be approximately \$125 million.

As discussed in *Current Operating Conditions and Outlook* *Current Events* above, our construction business encountered operational difficulties starting in the second quarter of fiscal year 2009, which resulted in higher non-reimbursable delivery costs and contractual milestone delays. As a result, a contract loss reserve and associated provision, specific to a large fixed price type construction contract in Afghanistan, were estimated and recorded during the second quarter of fiscal year 2009 which totaled \$18.4 million. During the third quarter of fiscal year 2009, we continued to encounter challenges despite significant progress and improvements on this construction project. Based on our assessment of the current status of this project and considering the current security environment in Afghanistan, an additional contract loss of \$2.1 million was recorded in the third quarter of fiscal year 2009. Utilization of the contract loss reserve through January 2, 2009 was \$10.4 million.

The recording of the additional loss also triggered an interim assessment of goodwill for potential impairment, as further discussed in Note 3 to our financial statements. As a result of this assessment, we concluded that no goodwill impairment had occurred.

**Table of Contents**

Additionally, revisions were made to the estimated margins on all other fixed priced Afghanistan construction contracts within the OMCM strategic business unit, resulting in a reduction to gross profit of \$6.1 million during the second quarter of fiscal year 2009. No further adjustments were made during the third quarter of fiscal year 2009. These fixed price Afghanistan construction contracts are expected to operate with margins at or approaching zero over their remaining contract terms.

The contract loss provision and revisions to estimated margins are based on the best information currently available. Although we believe that these amounts have been estimated appropriately, there can be no assurance that future events will not require us to revise these estimates.

*Results by Segment*

The following table sets forth the revenue and operating income for our ISS, LCM and MTSS operating segments, both in dollars and as a percentage of our consolidated revenue for segment revenue and as a percentage of our consolidated operating income for segment specific operating income, for the three and nine months ended January 2, 2009 as compared to the fiscal three and nine months ended December 28, 2007.

*Three Months Ended January 2, 2009 Compared to Three Months Ended December 28, 2007*

<i>(Amounts in thousands)</i>	<b>Three Months Ended</b>			
	<b>January 2, 2009</b>		<b>December 28, 2007</b>	
<b>Revenue</b>				
International Security Services	\$ 465,757	58.8%	\$ 265,722	50.8%
Logistics and Construction Management	90,423	11.4%	73,064	14.0%
Maintenance and Technical Support Services	237,842	30.0%	184,285	35.2%
Other/elimination	(1,695)	-0.2%		0.0%
Consolidated	\$ 792,327	100.0%	\$ 523,071	100.0%
<b>Operating Income &amp; Margin</b>				
International Security Services	\$ 33,167	7.1%	\$ 20,576	7.7%
Logistics and Construction Management	536	0.6%	5,016	6.9%
Maintenance and Technical Support Services	17,880	7.5%	5,233	2.8%
Consolidated	\$ 51,583	6.5%	\$ 30,825	5.9%

***International Security Services***

*Revenue* Revenue for the three months ended January 2, 2009 increased \$200.0 million, or 75.3%, as compared with the three months ended December 28, 2007. The increase primarily resulted from the following:

Law Enforcement and Security: Revenue increased \$13.2 million, or 8.2%, primarily due to increases in our security services in Iraq, Palestine, Liberia, Haiti and Qatar, offset by a decline in security services in Afghanistan. Revenue from our civilian police services in Iraq increased \$16.4 million primarily due to higher personnel levels. As a result of new contracts started in early fiscal year 2009, we provided civilian police and security services in Palestine, Haiti and Liberia, which contributed \$6.2 million, \$1.1 million and \$0.8 million, respectively, in increased revenue for the period. These increases were offset by a decline in Afghanistan, which was a result primarily of a shift from a fixed price contract structure in fiscal year 2008 to a cost reimbursable contract structure in fiscal year 2009. Revenue also was impacted by fewer supplies and equipment sales to the customer in Afghanistan during the three months ended January 2, 2009 as compared to the three months ended December 28, 2007.

Specialty Aviation and Counter-drug Operations: Revenue decreased \$10.6 million, or 10.3%, primarily due to a decline in our International Narcotics Law Enforcement programs resulting from scope reductions, offset by new contracts associated with security and drug eradication training in Afghanistan.



**Table of Contents**

Global Linguist Solutions: Revenue was \$199.0 million for the INSCOM contract through our GLS joint venture, which began in the fourth quarter of fiscal year 2008. Revenue also benefited from the recognition of the GLS award fee of \$7.8 million for the quarter. The award fee is based on achieving specific contract performance criteria, such as operational fill rates. Based on our contract performance history to date, we anticipate the ability to accrue award fees through the remaining life of the contract.

*Operating Income* Operating income for the three months ended January 2, 2009 increased \$12.6 million, or 61.2%, as compared with the three months ended December 28, 2007. The increase primarily resulted from the following:

*Law Enforcement and Security:* Operating income decreased \$6.3 million, or 22.6%, due to declining margins, primarily in our Civilian Police services. This margin decline resulted from a shift in portions of our task orders for these services from fixed price type in the prior fiscal year to cost reimbursable in the current fiscal year.

*Specialty Aviation and Counter-drug Operations:* Operating income increased \$0.3 million, or 3.4%, primarily due to higher margins on several new security and drug eradication training contracts in Afghanistan, offset by lower revenue for the fiscal quarter.

Global Linguist Solutions: Operating income was \$10.4 million for GLS for the three months ended January 2, 2009. Operating income benefited from GLS revenue, including the accrual of the GLS award fee of \$7.8 million, which represents the award earned or accrued during the quarter. The award fee is based on achieving specific contract performance criteria, such as operational fill rates.

General SG&A Factors: SG&A expense declined for the three months ended January 2, 2009, as compared to the three months ended December 28, 2007. The decline in SG&A expense in the current period as compared to the prior period, was primarily a result of improved SG&A cost management during the current period. This SG&A decline contributed positively to operating income growth for the fiscal quarter.

***Logistics and Construction Management***

*Revenue* Revenue for the three months ended January 2, 2009 increased \$17.4 million, or 23.8%, as compared with the three months ended December 28, 2007. The increase primarily resulted from the following:

*Contingency and Logistics Operations:* Revenue increased by \$1.0 million, or 2.2%, primarily due to the expansion of operations services in the Philippines, which increased \$9.7 million. Revenue also benefited from our continued support services, primarily through providing temporary housing in response to the severe flooding in Iowa during the summer of 2008 and increased services provided in Sudan. These increases were offset by a decline in our Africa Peacekeeping program, primarily a result of reductions in current work levels within this program.

*Operations Maintenance and Construction Management:* Revenue increased \$15.2 million, or 56.3%, primarily due to continued progress on our Afghanistan construction projects and contract closeout activities for a construction project in Nigeria. As discussed above in *Results of Operations Consolidated Impact of our Afghanistan Construction Contracts*, due to significant challenges on several Afghanistan construction contracts resulting partly from the deteriorating security situation in that country, we do not expect to bid on any similar fixed-price contracts without revised terms and conditions. This may impact future revenue in this segment by limiting the construction opportunities available to us.

*Operating Income* Operating income for the three months ended January 2, 2009 decreased \$4.5 million, or 89.3%, as compared with the three months ended December 28, 2007. The decrease primarily resulted from the following:

*Contingency and Logistics Operations:* Operating income decreased by \$0.9 million, or 35.7%, for the three months ended January 2, 2009, as compared to the three months ended December 28, 2007. The decrease was primarily driven by higher costs in the current quarter related to the ramp-up of our new LOGCAP IV contract, which was awarded in early fiscal year 2009. Currently, LOGCAP IV does not contribute significantly to revenue but incurs costs associated with contract set-up and other overhead costs. Additionally, several programs which contributed positively to revenue growth in the quarter did not contribute to operating income since we have not yet recognized award fees. We anticipate an increase in operating income associated with these projects once we have completed portions of the projects and recognize award fees as revenue in accordance with our policies.





**Table of Contents**

Operations Maintenance and Construction Management: Operating income increased by \$0.2 million, or 21.2%, for the three months ended January 2, 2009, as compared to the three months ended December 28, 2007, primarily due to contract closeout activities for a construction project in Nigeria. Partially offsetting the increase was the additional contract loss provision associated with a specific construction project in Afghanistan, as discussed above in Results of Operations Consolidated Impact of our Afghanistan Construction Contracts.

**Maintenance and Technical Support Services**

**Revenue** Revenue for the three months ended January 2, 2009 increased \$53.6 million, or 29.1%, as compared with the three months ended December 28, 2007. The increase primarily resulted from the following:

Contract Logistics Support: Revenue increased \$18.8 million, or 36.7%, primarily due to higher deliveries of support equipment associated with our C-21 and Life Cycle Contractor Support ( LCCS ) programs. This increase is primarily due to scope increases from the U.S. government for spending related to the global war on terror.

Field Service Operations: Revenue increased \$12.6 million, or 15.7%, primarily due to a new contract for logistics services at Fort Campbell, which started in May 2008, and additional revenue from higher personnel levels in our CFT program.

Aviation and Maintenance Services: Revenue increased \$22.0 million, or 41.4%, primarily due to increased work associated with MRAP vehicles and increased revenue associated with our General Maintenance Corps contract. These increases were offset by a decline in our marine services and a decrease in threat management systems work.

**Operating Income** Operating income for the three months ended January 2, 2009 increased \$12.6 million, to \$17.9 million, as compared to \$5.2 million for the three months ended December 28, 2007. The increase primarily resulted from the following:

Contract Logistics Support: Operating income for the three months ended January 2, 2009 increased by \$4.2 million, to \$4.8 million, as compared to operating income of \$0.6 million for the three months ended December 28, 2007. The positive results were primarily due to improved project management in several key programs.

Field Service Operations: Operating income increased \$0.5 million, or 10.4%, for the three months ended January 2, 2009, as compared to the three months ended December 28, 2007, driven primarily by increased revenue.

Aviation and Maintenance Services: Operating income increased \$8.6 million, or 193.6%, for the three months ended January 2, 2009, as compared to the three months ended December 28, 2007, primarily due to increased revenue in key high-margin service areas such as our MRAP program.

**Nine Months Ended January 2, 2009 Compared to Nine Months Ended December 28, 2007**

<i>(Amounts in thousands)</i>	<b>Nine months ended</b>			
	<b>January 2, 2009</b>		<b>December 28, 2007</b>	
<b>Revenue</b>				
International Security Services	\$ 1,343,467	58.7%	\$ 825,134	52.7%
Logistics and Construction Management	269,351	11.8%	183,815	11.7%
Maintenance and Technical Support Services	679,449	29.7%	557,904	35.6%
Other/elimination	(3,995)	-0.2%		0.0%
Consolidated	\$ 2,288,272	100.0%	\$ 1,566,853	100.0%
<b>Operating Income &amp; Margin</b>				
International Security Services	\$ 108,545	8.0%	\$ 78,069	9.5%
Logistics and Construction Management	(16,451)	(6.1)%	4,674	2.5%
Maintenance and Technical Support Services	46,116	6.8%	14,231	2.6%
Consolidated	\$ 138,210	6.0%	\$ 96,974	6.2%



**Table of Contents*****International Security Services***

**Revenue** Revenue for the nine months ended January 2, 2009 increased \$518.3 million, or 62.8%, as compared with the nine months ended December 28, 2007. The increase primarily resulted from the following:

**Law Enforcement and Security:** Revenue increased \$8.9 million, or 1.7%, primarily due to increases in our security services in Iraq, Palestine, Liberia, Haiti and Qatar, offset by a decline in Afghanistan. Revenue from our civilian police services in Iraq increased \$7.5 million primarily due to higher personnel levels offset by non-recurring revenue from fiscal year 2008 related to transition of our operations from leased facilities to customer furnished facilities in May 2007. Revenue also increased \$19.7 million under our Palestinian security sector program for which we provide equipment and supplies in addition to security services. We benefited from new contracts started in early fiscal year 2009, through which we provide civilian police and security services in Liberia, Haiti and Qatar. These contracts contributed \$3.0 million, \$2.8 million and \$2.4 million, respectively, in increased revenue for the period. These increases were offset by the decline in Afghanistan which was a result primarily from non-recurring revenue recognized in the prior year associated with our construction of a camp facility, completed in August 2007. Also contributing to the revenue decline in Afghanistan was the shift in contract structure specific to our services providing supplies and equipment, from a fixed price contract structure in fiscal year 2008 to a cost reimbursable contract structure in fiscal year 2009. The impact of the change in contract structure was further amplified by a reduction in the volume of supplies and equipment provided to customers in Afghanistan during the nine months ended January 2, 2009 as compared to the nine months ended December 28, 2007.

**Specialty Aviation and Counter-drug Operations:** Revenue decreased \$7.1 million, or 2.3%, primarily due to declines in our International Narcotics Law Enforcement programs as a result of program scope reductions offset by new contracts associated with security and drug eradication training in Afghanistan.

**Global Linguist Solutions:** Revenue was \$518.7 million for the INSCOM contract, which we perform through our GLS joint venture. Revenue also benefited from the recognition of the GLS award fee of \$22.2 million, which represents the award earned or accrued since the contract's inception. The award fee is based on achieving specific contract performance criteria, such as operational fill rates.

**Operating Income** Operating income for the nine months ended January 2, 2009 increased \$30.5 million, or 39.0%, as compared with the nine months ended December 28, 2007. The increase primarily resulted from the following:

**Law Enforcement and Security:** Operating income decreased \$23.9 million, or 23.9%, primarily due to declining margins in our civilian police services. This margin decline resulted from a shift in portions of our task orders for supplies and equipment related to these services from primarily fixed price type in the prior period to cost reimbursable type in the current period.

**Specialty Aviation and Counter-drug Operations:** Operating income increased \$10.3 million, or 59.0%, primarily due to higher margins on several new security and drug eradication training contracts in Afghanistan.

**Global Linguist Solutions:** Operating income was \$29.4 million for GLS for the nine months ended January 2, 2009. Operating income benefited from GLS revenue, including the accrual of the GLS award fee of \$22.2 million, which represents the award earned or accrued since the contract's inception. The award fee is based on achieving specific contract performance criteria, such as operational fill rates.

**General SG&A Factors:** SG&A expense declined for the nine months ended January 2, 2009, as compared to the nine months ended December 28, 2007. The decline in SG&A expense in the current period as compared to the prior period, was principally a result of prior period proposal costs associated with the INSCOM contract combined with improved SG&A cost management during the current period. This SG&A decline contributed positively to operating income growth for the fiscal quarter.

**Table of Contents*****Logistics and Construction Management***

**Revenue** Revenue for the nine months ended January 2, 2009 increased \$85.5 million, or 46.5%, as compared with the nine months ended December 28, 2007. The increase primarily resulted from the following:

Contingency and Logistics Operations: Revenue increased by \$23.9 million, or 24.8%, for the nine months ended January 2, 2009, as compared to the nine months ended December 28, 2007. This increase was primarily due to the expansion of operations services in the Philippines, which increased \$14.9 million. Revenue also benefited from an increase in our support services, primarily through providing temporary housing in response to the severe flooding in Iowa during the summer of 2008, adding \$12.0 million in additional revenue as compared to the prior period. These increases were primarily offset by a decline in our Africa Peacekeeping program, primarily a result of reductions in current work levels within this program.

Operations Maintenance and Construction Management: Revenue increased \$59.7 million, or 68.3%, for the nine months ended January 2, 2009, as compared to the nine months ended December 28, 2007, primarily due to our construction projects in Africa and Afghanistan. As discussed above in Results of Operations Consolidated Impact of our Afghanistan Construction Contracts, due to significant challenges on several Afghanistan construction contracts resulting partly from the deteriorating security situation in that country, we do not expect to bid on any similar fixed-price contracts without revised terms and conditions. This strategic decision may impact future revenue in this segment by limiting the construction opportunities available to us.

**Operating Income** Operating income decreased \$21.1 million, to an operating loss of \$16.5 million, for the nine months ended January 2, 2009, as compared to operating income of \$4.7 million for the nine months ended December 28, 2007. The decrease primarily resulted from the following:

Contingency and Logistics Operations: Operating income decreased \$1.4 million, or 19.9%, for the nine months ended January 2, 2009, as compared to the nine months ended December 28, 2007. We experienced higher costs in the current period related to the ramp-up of our new LOGCAP IV contract which was awarded in early fiscal year 2009. Currently, LOGCAP IV incurs costs associated with contract set-up and other overhead costs without a significant revenue contribution.

Operations Maintenance and Construction Management: Operating loss was \$16.3 million for the nine months ended January 2, 2009, as compared to operating income of \$1.7 million for the nine months ended December 28, 2007. As discussed above in Results of Operations Consolidated Impact of our Afghanistan Construction Contracts, the operating loss in the current period was the result of a contract loss provision associated with a specific construction project in Afghanistan and adjustment to our estimated margins on several other Afghanistan construction projects.

***Maintenance and Technical Support Services***

**Revenue** Revenue for the nine months ended January 2, 2009 increased \$121.5 million, or 21.8%, as compared with the nine months ended December 28, 2007. The increase primarily resulted from the following:

Contract Logistics Support: Revenue increased \$35.6 million, or 23.5%, primarily due to higher deliveries of support equipment associated with our C-21 and LCCS programs. This increase is primarily due to scope increases from the U.S. government for spending related to the global war on terror.

Field Service Operations: Revenue increased \$27.6 million, or 11.1%, for the nine months ended January 2, 2009, as compared to the nine months ended December 28, 2007, primarily due to a new contract for logistics services at Fort Campbell which started in May 2008 and additional revenue from higher personnel levels in our CFT program.

**Table of Contents**

Aviation and Maintenance Services: Revenue increased \$56.8 million, or 36.0%, for the nine months ended January 2, 2009, as compared to the nine months ended December 28, 2007, primarily due to increased work associated with MRAP vehicles and increased revenue associated with our General Maintenance Corps contract. These increases were partially offset by declines in our marine services, Columbus Air Force Base support services and in our threat management systems work.

*Operating Income* Operating income for the nine months ended January 2, 2009 increased \$31.9 million, to \$46.1 million, as compared to \$14.2 million for the nine months ended December 28, 2007. The increase primarily resulted from the following:

Contract Logistics Support: Operating income for the nine months ended January 2, 2009 increased by \$8.0 million, to \$7.2 million as compared to a \$0.7 loss for the nine months ended December 28, 2007. The positive results were primarily due to improved project management in several key programs.

Field Service Operations: Operating income increased \$2.5 million, or 16.1%, for the nine months ended January 2, 2009, as compared to the nine months ended December 28, 2007, primarily due to increased revenue.

Aviation and Maintenance Services: Operating income increased \$23.9 million, or 220.2%, for the nine months ended January 2, 2009, as compared to the nine months ended December 28, 2007, primarily due to increased revenue and improved margins in our MRAP program.

**LIQUIDITY AND CAPITAL RESOURCES**

Cash generated by operations and borrowings available under our Revolving Facility are our primary sources of short-term liquidity. Based on our current level of operations, we believe our cash flow from operations and our available borrowings under our Revolving Facility will be adequate to meet our liquidity needs for at least the next twelve months. However, we cannot assure you that our business will generate sufficient cash flow from operations, or that future borrowings will be available to us under our Revolving Facility in an amount sufficient to enable us to repay our indebtedness or to fund our other liquidity needs.

We are required, under certain circumstances as defined in our Credit Facility, to use a percentage of cash generated from operations to reduce the outstanding principal of our Term Loan. The actual amount of the required repayment if any, in respect to fiscal year 2009, could vary significantly based on such factors as the timing of cash receipts and cash payments near fiscal year end. Because of this, we cannot make a reasonable estimate of our required repayment if any, in respect to fiscal year 2009. In the event a repayment is required to be made, which would be paid during our first quarter of fiscal year 2010, we anticipate utilizing borrowings under our Revolving Facility to make sure payment.

*Cash Flow Analysis*

The following table sets forth cash flow data for the periods indicated.

<i>(Amounts in thousands)</i>	<b>Nine Months Ended</b>	
	<b>January 2, 2009</b>	<b>December 28, 2007</b>
Net Cash provided by (used in) operating activities	\$ 70,195	\$ (49,256)
Net Cash (used in) investing activities	(22,070)	(7,241)
Net Cash provided by (used in) financing activities	17,076	(32,377)

Cash provided by operating activities for the nine months ended January 2, 2009 was \$70.2 million as compared to \$49.3 million cash used for operations for the nine months ended December 28, 2007. Our positive operating cash flow for the period was primarily the result of higher cash generated from operations offset by a reduction in cash from an increase in our net working capital. Cash generated from operations benefited from our continued revenue growth from new contracts. The change in net working capital was primarily due to an increase in accounts receivable. Net of revenue growth, our accounts receivable actually declined due to improved collection efforts implemented during the nine months ended January 2, 2009. As a result of these efforts, days sales outstanding, a key metric utilized by management to monitor collection efforts on accounts receivable, decreased from 92 days as of December 28, 2007 to 69 days as of January 2, 2009.



**Table of Contents**

Cash used in investing activities was \$22.1 million for the nine months ended January 2, 2009 as compared to \$7.2 million for the nine months ended December 28, 2007. This use of cash from investing activities was primarily a result of changes in our cash restricted as collateral on letters of credit of \$15.2 million. Additionally, the combination of PP&E and software purchases used approximately \$5.0 million for the nine months ended January 2, 2009.

Cash provided by financing activities was \$17.1 million for the nine months ended January 2, 2009, as compared to cash used of \$32.4 million for the nine months ended December 28, 2007. The cash provided by financing activities during the period was primarily from the \$12.8 million net effect of extinguishing debt and issuing new debt discussed below as well as in Note 5 of our financial statements. This also included the \$4.3 million in cash provided from net borrowings to finance insurance policies. Cash used of \$32.4 in financing activities for the nine months ended December 28, 2007 was due primarily to repayments of principal on debt.

*Financing*

Our Credit Facility consists of a revolving credit facility of \$200.0 million (including a letter of credit sub facility of \$125.0 million) (the Revolving Facility ) and a term loan facility of \$200.0 million (the Term Loan Facility ). We have borrowed \$200.0 million under the Term Loan Facility at the LIBOR rate plus the applicable margin then in effect, see Quantitative and Qualitative Disclosures About Market Risk Interest Rate Risk. The maturity date of the Revolving Facility and the Term Loan Facility is August 15, 2012.

As of January 2, 2009, no balance was outstanding under the Revolving Facility, and \$200.0 million was outstanding under the Term Loan Facility. Our available borrowing capacity under the Revolving Facility totaled \$185.8 million at January 2, 2009, which gives effect to \$14.2 million of outstanding letters of credit. We have entered into interest rate swap agreements to hedge our exposure to interest rate increases on a notional principal amount of \$200.0 million.

As of January 2, 2009, \$415.9 million of principal amount of senior subordinated notes was outstanding, net of a \$1.1 million unamortized discount. Our senior subordinated notes mature during February 2013. Interest on the senior subordinated notes is payable semi-annually.

*Debt Covenants and Other Matters*

The Credit Facility contains various financial covenants, including a total leverage ratio, an interest coverage ratio, limitations on capital expenditures and certain limitations based upon eligible accounts receivable. The Credit Facility and the indenture pertaining to the senior subordinated notes also contain covenants that restrict the ability of the Company and its subsidiaries to, among other things, dispose of assets; incur additional indebtedness; prepay other indebtedness or amend certain debt instruments; pay dividends; create liens on assets; enter into sale and leaseback transactions; make investments, loans or advances; issue certain equity instruments; make acquisitions; engage in mergers or consolidations or engage in certain transactions with affiliates.

At January 2, 2009, we were in compliance with the financial and non-financial covenants contained in the Credit Facility and the indenture pertaining to the senior subordinated notes.

**OFF BALANCE SHEET ARRANGEMENTS**

Our off-balance sheet arrangements relate to operating lease obligations and letters of credit, which are excluded from the balance sheet in accordance with GAAP. Our letters of credit and lease obligations are described in Notes 5 and 6, respectively, in the notes to our consolidated financial statements.



**Table of Contents**

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

Management's discussion and analysis of financial condition and results of operations are based on our condensed consolidated financial statements and related footnotes contained within this Quarterly Report. Our more critical accounting policies used in the preparation of the consolidated financial statements were discussed in our 2008 Annual Report on Form 10-K for the fiscal year ended March 28, 2008, filed with the SEC on June 10, 2008. There have been no material changes to our critical accounting policies and estimates from the information provided in our Annual Report on Form 10-K for the fiscal year ended March 28, 2008.

The process of preparing financial statements in conformity with GAAP requires the use of estimates and assumptions to determine certain of the assets, liabilities, revenues and expenses. These estimates and assumptions are based upon what we believe is the best information available at the time of the estimates or assumptions. The estimates and assumptions could change materially as conditions within and beyond our control change. Accordingly, actual results could differ materially from those estimates.

Based on an assessment of our accounting policies and the underlying judgments and uncertainties affecting the application of those policies, we believe that our condensed consolidated financial statements provide a meaningful and fair perspective of our consolidated financial condition and results of operations.

**ACCOUNTING DEVELOPMENTS**

We have presented the information about accounting pronouncements not yet implemented in Note 1 to our condensed consolidated financial statements included in this Quarterly Report.

**DISCLOSURE REGARDING FORWARD-LOOKING INFORMATION**

This Quarterly Report on Form 10-Q contains various 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 (the Exchange Act). Forward-looking statements, written, oral or otherwise made, represent the Company's expectation or belief concerning future events. Without limiting the foregoing, the words believes, thinks, anticipates, plans, and similar expressions are intended to identify forward-looking statements. Statements regarding the amount of our backlog, estimated remaining contract values and estimated total contract values are other examples of forward-looking statements. Forward-looking statements involve risks and uncertainties. We caution that these statements are further qualified by important economic, competitive, governmental and technological factors that could cause our business, strategy or actual results or events to differ materially, or otherwise, from those in the forward-looking statements. These factors, risks and uncertainties include, among others, the following: our substantial level of indebtedness; government policies and changes thereto; termination of key U.S. government contracts; changes in the demand for services that we provide; pursuit of new commercial business and foreign government opportunities; activities of competitors; bid protests; changes in significant operating expenses; changes in availability of capital; general economic and business conditions in the U.S.; acts of war or terrorist activities; variations in performance of financial markets; the inherent difficulties of estimating future contract revenue; anticipated revenue from indefinite delivery, indefinite quantity contracts; expected percentages of future revenue represented by fixed-price and time-and-materials contracts; and other risks detailed from time to time in our reports filed with the SEC. Accordingly, such forward-looking statements do not purport to be predictions of future events or circumstances and therefore there can be no assurance that any forward-looking statement contained herein will prove to be accurate. We assume no obligation to update the forward-looking statements.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The inherent risk in market risk sensitive instruments and positions primarily relates to potential losses arising from adverse changes in interest rates and foreign currency exchange rates. For further discussion of market risks we may encounter, see Risk Factors in the Company's Annual Report on Form 10-K for the fiscal year ended March 28, 2008, filed with the SEC on June 10, 2008.

**Table of Contents****Interest Rate Risk**

We have interest rate risk relating to changes in interest rates on our variable rate debt. Our policy is to manage interest rate exposure through the use of a combination of fixed and floating rate debt instruments. Borrowings under the Notes are at a fixed rate and represent the largest portion of our debt as of January 2, 2009. Borrowings under the senior secured credit facility bear interest at a rate per annum equal to, at our option, either (1) a base rate or (2) LIBOR, plus, in either case, an applicable margin determined by reference to the leverage ratio, as set forth in the senior secured credit agreement. The applicable margins for the base rate and LIBOR rate as of January 2, 2009 were 1.5% and 2.5% respectively. As of January 2, 2009, we had \$615.9 million of indebtedness, including the Notes and excluding accrued interest thereon, of which \$200.0 million was secured. On the same date, we had approximately \$185.8 million available under our senior secured credit facility (which gives effect to \$14.2 million of outstanding letters of credit). Each quarter point change in interest rates results in an approximately \$0.5 million change in annual interest expense on the senior secured credit facility.

The table below provides information about our fixed rate and variable rate long-term debt as of January 2, 2009.

	Expected Maturity as of						Total
	2009	2010	2011	Fiscal Year 2012	2013	Thereafter	
Fixed rate	\$	\$	\$	\$	\$417,032	\$	\$417,032
Variable rate		16,875	50,625	55,500	77,000		200,000
Total debt		16,875	50,625	55,500	494,032		617,032

The fair value of our term loan borrowings under the senior secured credit facility is approximately \$200.0 million. The fair value of the Notes is approximately \$362.8 million based on their quoted market value. The above table does not give effect to \$28.6 million of outstanding letters of credit, \$14.4 million of which were collateralized by restricted cash, or unamortized discount of \$1.1 million on the Notes, in each case as of January 2, 2009.

During fiscal 2008, in order to mitigate interest rate risk related to our floating rate indebtedness, we entered into interest rate swap agreements with notional amounts totaling \$275.0 million. The interest rate swaps effectively fixed the interest rate at 6.96%, including applicable margin of 2% at March 28, 2008, on the first \$275.0 million of our floating rate debt. The interest rate on the notional amount of \$75.0 million was effectively fixed through September 2008 and the interest rate on the remaining \$200.0 million was effectively fixed through May 2010. We concluded that the interest rate swaps qualify as cash flow hedges under the provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*.

**Foreign Currency Exchange Rate Risk**

We are exposed to changes in foreign currency rates. At present, we do not utilize any derivative instruments to manage risk associated with currency exchange rate fluctuations. The functional currency of certain foreign operations is the local currency. Accordingly, these foreign entities translate assets and liabilities from their local currencies to U.S. dollars using year-end exchange rates while income and expense accounts are translated at the average rates in effect during the year. The resulting translation adjustment is recorded as accumulated other comprehensive (loss) income. Management has determined that our foreign currency transactions are not material.

**ITEM 4. CONTROLS AND PROCEDURES****(a) Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, has evaluated our disclosure controls and procedures (as such term is defined in Rules 13a-15 and 15d-15 of the Exchange Act). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective to ensure that information required to be disclosed in reports that we file or submit under the Exchange Act are: (1) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms; and (2) accumulated and

communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

**Table of Contents**

***(b) Changes in Internal Controls***

There have been no changes in our internal controls over financial reporting that have occurred during the fiscal quarter ended January 2, 2009 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

**PART II OTHER INFORMATION**

**ITEM 1. LEGAL MATTERS**

Information related to various commitments and contingencies is described in Note 6 to the condensed consolidated financial statements.

**ITEM 1A. RISK FACTORS**

There have been no material changes in risk factors from those described in Part I, Item 1A, "Risk Factors" in the Company's Annual Report on Form 10-K for the fiscal year ended March 28, 2008, filed with the SEC on June 10, 2008, except as follows:

***Current or worsening economic conditions could impact our business.***

Over the last several months, there has been a significant deterioration in the U.S. and global economy, which many economic observers expect to worsen and be prolonged. In addition, liquidity has contracted significantly and borrowing rates have increased. We believe that our industry and customer base are less likely to be affected by many of the factors affecting business and consumer spending generally. Accordingly, we believe that we continue to be well positioned in the current economic environment as a result of historic demand factors affecting our industry, the nature of our contracts and our sources of liquidity. However, we cannot assure you that the economic environment or other factors will not adversely impact our business, financial condition or results of operations in the future. In particular, if the Federal government, due to budgetary considerations, accelerates the expected reduction in combat troops from Iraq, fails to implement expected troop increases in Afghanistan, otherwise reduces the DoD Operations and Maintenance budget or reduces funding for DoS initiatives in which we participate, our business, financial condition and results of operations could be adversely affected.

Furthermore, although we believe that our current sources of liquidity will enable us to continue to perform under our existing contracts and further grow our business, we cannot assure you that will be the case. A longer term credit crisis could adversely affect our ability to obtain additional liquidity or refinance existing indebtedness on acceptable terms or at all, which could adversely affect our business, financial condition and results of operations.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.

**ITEM 5. OTHER INFORMATION**

None.

**Table of Contents**

**ITEM 6. EXHIBITS**

The following exhibits are filed as part of, or incorporated by reference into, the Quarterly Report on Form 10-Q.

<b>Exhibit Number</b>	<b>Description</b>
10.1*	Employment Agreement effective as of December 29, 2008, between DynCorp International LLC and Tony Smeraglinolo.
31.1*	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* Filed herewith.

**SIGNATURES**

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

**DYNCORP INTERNATIONAL INC.**

Date: February 10, 2009

/s/ MICHAEL J. THORNE

Name: Michael J. Thorne

Title: Senior Vice President and Chief  
Financial Officer