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ENGINEERED SUPPORT SYSTEMS INC  
Form 10-K  
January 14, 2005

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d)

of the Securities Exchange Act of 1934

For the year ended October 31, 2004

Commission file number 0-13880

ENGINEERED SUPPORT SYSTEMS, INC.

(Exact name of Registrant as specified in its charter)

Missouri  
(State of Incorporation)

43-1313242  
(IRS Employer Identification No.)

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

63121  
(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Securities Exchange Act of 1934: None

Securities registered pursuant to Section 12(g) of the Securities Exchange Act of 1934:

Title of each class -----	Name of each exchange on which registered -----
Common stock, \$.01 par value	Nasdaq National Market System

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 requirement for the past 90 days.

Yes X No .  
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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in the definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. X  
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Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).

Yes X No .  
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Based on the closing price on December 31, 2004, the aggregate market value of the voting stock held by non-affiliates of the Registrant was approximately \$1,241,347,000.

The number of shares of the Registrant's common stock, \$.01 par value, outstanding at December 31, 2004 was 26,837,381.

### DOCUMENTS INCORPORATED BY REFERENCE

Parts I and II incorporate by reference portions of the Engineered Support Systems, Inc. Annual Report to Shareholders (the Annual Report) for the year ended October 31, 2004. Part III incorporates by reference portions of the Engineered Support Systems, Inc. Proxy Statement for the Annual Shareholders Meeting to be held on March 1, 2005 (the Definitive Proxy Statement) to be filed within 120 days after the close of the year ended October 31, 2004.

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### PART I

#### ITEM 1. BUSINESS

Engineered Support Systems, Inc. (the Company) is a holding company for twelve wholly-owned subsidiaries. These subsidiaries are organized within the Company's two business segments: Support Systems and Support Services. The Support Systems segment designs, engineers and manufactures integrated military electronics and other military support equipment primarily for the U.S. Department of Defense (DoD), as well as related heat transfer and air handling equipment for domestic commercial and industrial users, and material handling equipment primarily for the U.S. Postal Service. The Support Systems segment includes the operations of Systems & Electronics Inc. (SEI), Keco Industries, Inc. (Keco), Engineered Air Systems, Inc. (Engineered Air), Engineered Coil Company, d/b/a Marlo Coil (Marlo Coil), Engineered Electric Company, d/b/a Fermont (Fermont), Universal Power Systems, Inc. (UPSI), Engineered Environments, Inc. (EEi), Pivotal Power Inc. (Pivotal Power) and Prospective Computer Analysts Incorporated (PCA), which was acquired January 7, 2005. The Support Services segment provides engineering services, logistics and training services, advanced technology services, asset protection systems and services, telecommunication systems integration and information technology services primarily for the DoD. The Support Services segment includes the operations of Technical and Management Services Corporation (TAMSCO), Radian, Inc. (Radian) and ESSBuy.com, Inc. (ESSBuy). Substantially all revenues within these two segments are directly or indirectly derived from contracts with the DoD and certain foreign militaries.

Engineered Air was incorporated under the laws of the State of Missouri on December 24, 1981 and acquired the assets of the Defense Systems Division of Allis-Chalmers Corporation on March 30, 1982. The Company was incorporated under the laws of the State of Missouri in December 1983, and exchanged all of its outstanding common stock for two-thirds of the common stock of Engineered Air held by the Company's founders. The Company purchased the remaining one-third of the common stock of Engineered Air in January 1984, effective as of November 1, 1983. The Company became a publicly owned corporation on August 21, 1985. On March 9, 1993, the Company purchased all of the outstanding stock of Associated Products, Inc. (subsequently changed to Engineered Specialty

Plastics, Inc.). Effective February 1, 1998, Engineered Coil Company acquired substantially all of the net assets of Nuclear Cooling, Inc., d/b/a Marlo Coil. On June 24, 1998, the Company acquired all of the outstanding common stock of Keco. On February 22, 1999, Engineered Electric Company acquired substantially all of the net assets of the Fermont Division of Dynamics Corporation of America, d/b/a Fermont. On September 30, 1999, the Company acquired all of the outstanding common stock of SEI. On May 10, 2002, the Company acquired all the outstanding common stock of Radian. On June 27, 2002, the Company acquired all the outstanding stock of UPSI. On May 1, 2003, the Company acquired all of the outstanding stock of TAMSCO. On September 24, 2003, the Company acquired all of the outstanding stock of EEI. On December 5, 2003, the Company acquired all of the outstanding stock of Pivotal Power. On January 7, 2005, the Company acquired all of the outstanding stock of PCA. Effective December 9, 2004, the Company entered into a definitive purchase agreement to acquire the membership interests of Spacelink International, LLC. This transaction is expected to close in February, 2005.

#### PRODUCTS

Products within the Company's Support Systems segment include environmental control systems, load management and transport systems, power generation, distribution and conditioning systems, airborne radar systems, reconnaissance, surveillance and target acquisition systems, chemical and biological protection systems, petroleum and water distribution systems and other multipurpose military support equipment. The Support Services segment provides engineering services, logistics and training services, advanced technology services, asset protection systems and services, telecommunication systems integration and information technology services primarily for the DoD. The Support Services segment also provides certain power generation and distribution equipment and vehicle armor installation to the DoD.

The sections in the Annual Report entitled "Business Segments within Continuing Operations" within Management's Discussion and Analysis of Financial Condition and Results of Operations, and Note L of the Consolidated Financial Statements are incorporated herein by reference.

#### ENGINEERING AND DESIGN

As the Company has grown both internally and through acquisition, it has significantly increased its engineering capabilities. The Company currently has 965 people engaged in engineering activities that encompass advanced development, engineering research and development, product improvement and evolution, new product development, productionization, logistic and life cycle support, product re-engineering and support services. The Company's depth of engineering capabilities allows it to cover all phases of a project from conception to full-life cycle support.

The majority of development activities are conducted pursuant to, and funded directly or indirectly through, DoD contracts in response to designated performance specifications. The Company's expenditures on internal research and development (IRAD) were approximately \$4.3 million, \$2.9 million and \$1.8 million for the years ended October 31, 2004, 2003 and 2002, respectively. The Company anticipates that IRAD will approximate \$5.0 million in fiscal year 2005. The Company also anticipates a significant increase in DoD contracted research and development (CRAD) in fiscal 2005

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and beyond. The Company believes that its engineering expertise gives it a significant competitive advantage in the development of differentiated products.

The Company's engineering expertise is complementary to the military markets it serves, primarily the environmental control, power, electronics, heavy mechanical and material handling, security, communications, service and logistical support markets. The Company has engineering capabilities in the areas of system design and analysis, electronic signal processing, power electronics, software, firmware, mechanical design, control, electro-mechanical, electro-optical, electro-chemical, acoustics, thermodynamics, fluid and air flow, fluid pumping, HVAC, liquid fuel combustion, chemical and biological hardened environmental control, filtration and decontamination, power system analysis, environmental control system analysis, stress analysis, water treatment analysis, water purification technology, radar, target acquisition systems, automatic test equipment, communication system analysis and all the logistic support disciplines to include reliability, maintainability, embedded diagnostics and prognostics, training and the development of web-based interactive electronic technical manuals (IETM). Company subsidiaries

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within the Support Services segment have engineering expertise in such diverse fields as re-engineering obsolete mechanical and electronic products, nano-hardened products, security system design, fuel cells and super critical reformation. The Company's engineering expertise has significant overlap throughout its operating subsidiaries, allowing it to leverage engineering personnel and technologies, and to function as an integrated team.

The Company's design and development of new products is enhanced by a number of computer-aided design and manufacturing (CAD/CAM) systems as well as a number of automated system design and analysis tools. CAD/CAM tools are used by both engineers and draftsmen to design and validate complex products and component parts. The Company utilizes both two- and three-dimensional CAD/CAM tools, providing both design and production engineers an interactive environment with which to view the final product and all the relevant interfaces. These tools are compatible across all of the Company's operating subsidiaries, allowing for virtual design and development without regard to geographical location. The Company's engineering technologies and expertise provide it with the ability to adapt its production processes to new product needs on a timely basis. The Company also has the capability to provide complete technical data support for the products it manufactures to include integrated logistics support, spare parts provisioning and preparation of technical manuals.

The Company intends to leverage its engineering and design capabilities to continue to develop and evolve differentiated products and services that address both the current and future needs of the DoD for rapid deployment, smaller, lighter and more efficient equipment, and for innovative, value-added service offerings.

### MARKETING AND BUSINESS DEVELOPMENT

The Company's business development efforts are undertaken at two functional levels. The Company's corporate operation focuses on long-term strategic planning, policy development, best practice identification and dissemination, and on major programs which require the bundling of products and services across traditional subsidiary lines. In addition, the Company's

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corporate Washington D.C. operations interface with service staffs within the Pentagon and liaisons with key Congressional delegations. At the subsidiary level, a sales force is engaged

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to identify and pursue programs with specific customers in a variety of markets. With increased emphasis on the Company's vision for the future, efforts have begun to strengthen the long-term strategic planning process. Market-based peer groups enable experts throughout the Company to share knowledge and collectively recommend direction and strategy. These peer groups also evaluate market intelligence, customer knowledge and core competencies to refine the Company's growth strategies.

The Company's Business Development Organization meets on a regular basis to identify and disseminate best practices in the areas of proposal development and market presence. The sales force shares customer and market intelligence, identifies key opportunities and assesses campaign strategies. The Company gathers information from primary sources such as the DoD budget and its supporting documents, and military requirements documents such as Initial Capabilities Documents, along with direct interface with its customers. The Company analyzes this data through an established business opportunity procedure and then determines whether or not to bid on specific projects based upon determinations of potential profitability and the likelihood of award.

Major marketing and business development efforts in fiscal 2005 can be segmented into four areas. The first will be increasing the Company's relationship with prime contractors. With continued emphasis from DoD for Lead System Integrators (LSI) and few companies qualifying for that role, the Company has developed marketing efforts to support specific companies in their LSI roles. Secondly, the Company will continue to engage with non-traditional military customers, including the Homeland Security, the Coast Guard and international markets. Thirdly, significant resources will be devoted to winning next generation programs in our traditional markets of power generation, environmental controls and sustainment systems. Finally, as the DoD moves to reset equipment used 'in theatre', the Company will emphasize depot support initiatives that enable consistent and efficient refurbishment of equipment.

### PURCHASED COMPONENTS AND RAW MATERIALS

The Company's products require a wide variety of components and materials. Although the Company has multiple sources of supply for most of its material requirements, sole-source vendors supply certain components, and

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the Company's ability to perform certain contracts depends on their performance. In the past, these required raw materials and various purchased components generally have been available in sufficient quantities.

### GOVERNMENT CONTRACTING

The Company's government contracts are obtained through the DoD procurement process as governed by the Federal Acquisition Regulations and related regulations and agency supplements, and are typically fixed-price contracts. This means that the price is agreed upon before the contract is awarded and the Company assumes complete responsibility for any difference

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between estimated and actual costs.

Under the Truth in Negotiations Act of 1962 (Negotiations Act), the U.S. government has the right for three years after final payment on certain negotiated contracts, subcontracts and modifications thereto, to determine whether the Company furnished the U.S. government with complete, accurate and current cost or pricing data as defined by the Negotiations Act. In the event the Company fails to satisfy this requirement, the U.S. government has the right to adjust a contract or subcontract price by the amount of any overstatement as defined by the Negotiations Act.

U.S. government contracts permit the U.S. government to unilaterally terminate these contracts at its convenience. In the event of such termination, the Company is entitled to reimbursement for certain expenditures and overhead as provided for in applicable U.S. government procurement regulations. Generally, this results in the contractor being reasonably compensated for work actually done, but not for anticipated profits. The U.S. government may also terminate contracts for cause if the Company fails to perform in strict accordance with contract terms. The Company has never had a contract terminated by the U.S. government for failure to perform in accordance with contract terms. Termination of, or elimination of appropriation for, a significant government contract could have a material adverse effect on the Company's business, financial condition and results of operations in subsequent periods. Similarly, U.S. government contracts typically permit the U.S. government to change, alter or modify the contract at its discretion. If the U.S. government were to exercise this right, the Company

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could be entitled to reimbursement of all allowable and allocable costs incurred in making the change plus a reasonable profit.

For manufactured items, the U.S. government typically finances a substantial portion of the Company's contract costs through progress payments. As such, the Company receives progress payments in accordance with DoD contract terms which provide progress payments at 75% to 90% of costs incurred.

### INTELLECTUAL PROPERTY

The Company owns various patents and other forms of intellectual property. From time to time, the Company develops proprietary information and trade secrets regarding the design and manufacture of various products. The Company considers its proprietary information and intellectual property to be valuable assets. However, the Company's business is not materially dependent on their protection.

### COMPETITION

The markets for all of the Company's products and services are highly competitive. In order to obtain U.S. government contracts, the Company must comply with detailed and complex procurement procedures adopted by the DoD pursuant to regulations promulgated by the U.S. government. The regulations and procurement procedures are adopted to promote competitive bidding. In addition, the Company competes with a large number of suppliers to commercial and industrial air handling customers. In all phases of its operations, the Company competes in both performance and price with companies, some of which are considerably larger, more diversified and have greater financial resources than the Company.

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### BACKLOG

The Company records its backlog as either funded or unfunded backlog. The Company's funded backlog was \$588.1 million and \$533.4 million as of October 31, 2004 and 2003, respectively. The Company's funded backlog is subject to fluctuations and is not necessarily indicative of future revenues. Funded backlog represents

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products or services that the customer has committed by contract to purchase from the Company. Unfunded backlog includes products or services that the customer has the option to purchase under contract with the Company, including, with respect to contracts which include a maximum amount purchasable by the customer thereunder, such maximum amount, and with respect to contracts without a specified maximum amount, the Company's estimate of the amount it expects the customer to purchase using the Best Estimated Quantity (BEQ) as a guide where a BEQ is specified. There are no commitments by the customer to purchase products or services included in unfunded backlog and there can be no assurance that any or all amounts included therein will generate revenue for the Company. Moreover, cancellations of purchase orders or reductions of product quantities or levels of service to be provided in existing contracts could substantially reduce the Company's funded backlog and, consequently, future net revenues. Failure of the Company to replace canceled or reduced backlog, whether funded or unfunded, could have a material adverse effect on the Company's business, financial condition and results of operations in subsequent periods.

The following table summarizes funded and unfunded defense backlog (in millions) as of the indicated dates:

	Funded Defense Backlog -----	Unfunded Defense Backlog -----
October 31, 2004	\$588.1	\$849.2
October 31, 2003	533.4	922.8
October 31, 2002	350.1	868.6
October 31, 2001	291.7	681.8
October 31, 2000	307.3	598.1

### EMPLOYEES

As of October 31, 2004, the Company employed 3,277 persons, of which 1,168 were engaged in manufacturing activities, 965 in engineering activities and 1,144 in services activities, office administration and management functions. District No. 9 of the International Association of Machinists and Aerospace Workers (AFL-CIO) represents 371 employees under a collective bargaining agreement, which expires March 21, 2008.

The Company considers its overall employee relations to be satisfactory.

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### GEOGRAPHIC AREAS

The following table summarizes the Company's net revenues attributed to the United States and to foreign countries:

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Year Ended October 31 -----	United States -----	Foreign Countries -----	Total Revenues -----
2004	\$853,286	\$30,344	\$883,630
2003	556,809	15,892	572,701
2002	393,581	14,364	407,945

The Company attributes foreign net revenues based on the domicile of the purchaser of the product or service.

Of the \$511.1 million in total Company assets as of October 31, 2004, \$15.1 million were located in countries other than the U.S.

### FILING OF PERIODIC REPORTS

The Company regularly files periodic reports with the Securities and Exchange Commission (SEC), including annual reports on Form 10-K and quarterly reports on Form 10-Q, as well as, from time to time, current reports on Form 8-K and amendments to those reports. These filings are available free of charge on the Company's website at [www.engineeredsupport.com](http://www.engineeredsupport.com), as soon as reasonably practicable after their electronic filing with the SEC.

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### ITEM 2.                    PROPERTIES

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The Company conducts its business from 37 manufacturing, warehouse and office facilities.

Location -----	Description -----	Square Footage -----
West Plains, Missouri (1)	Manufacturing/Office	422,000
Florence, Kentucky (1)	Manufacturing/Office	265,000
St. Louis County, Missouri (1)	Subassembly/Office	256,000
High Ridge, Missouri (1)	Manufacturing/Office	185,000
Bridgeport, Connecticut (1)	Manufacturing/Office	109,000
Halifax, Nova Scotia, Canada (2)	Manufacturing/Office	40,000
Alexandria, Virginia (2)	Office	34,000
Cincinnati, Ohio (1)	Manufacturing/Office	31,000
Bridgeport, Connecticut (2)	Manufacturing	26,000
Polson, Montana (2)	Manufacturing/Office	24,000
Troy, Michigan (2)	Office	20,000
St. Louis County, Missouri (1)	Manufacturing	16,000
Chantilly, Virginia (2)	Office	16,000
Tinton Falls, New Jersey (2)	Office	15,000
St. Louis County, Missouri (2)	Warehouse	14,000
Calverton, Maryland (2)	Office	14,000
Warner Robins, Georgia (2)	Office	13,000
Fairborn, Ohio (2)	Office	13,000
Warner Robins, Georgia (1)	Office	11,000
Warner Robins, Georgia (2)	Manufacturing/Office	11,000
West Long, New Jersey (2)	Office	9,000
Huntsville, Alabama (2)	Office	8,000



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Melbourne, Florida (2)	Manufacturing/Office	8,000
Newington, Virginia (2)	Office	6,000
West Plains, Missouri (2)	Warehouse	5,000
Cincinnati, Ohio (2)	Manufacturing	5,000
Arlington, Virginia (2)	Office	4,000
Petersburg, Virginia (2)	Office	4,000
Garden City, New York (2)	Office	3,000
East Lake, Ohio (2)	Office	3,000
Fredericksburg, Virginia (2)	Office	2,000
Elizabeth City, North Carolina (2)	Office	2,000
Abington, Maryland (2)	Office	2,000
Coronado, California (2)	Office	1,000
Layton, Utah (2)	Office	1,000
San Diego, California (2)	Office	1,000
Shrewsbury, New Jersey (2)	Office	1,000