

DYNCORP INTERNATIONAL INC.
Form 10-Q
February 12, 2007

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 December 29, 2006

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, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

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As of February 12, 2007, the registrant had 57,000,000 shares of its Class A common stock, par value \$0.01 per share, outstanding.

DYNCORP INTERNATIONAL INC.

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PART I FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS****DYNCORP INTERNATIONAL INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands, except per share data)**

	December 29, 2006 (Unaudited)	March 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	\$ 55,336	\$ 20,573
Receivables, net of allowances for doubtful accounts of \$2,728 and \$8,479 at December 29, 2006 and March 31, 2006, respectively	446,735	437,947
Other receivables	1,893	2,248
Prepaid expenses and other current assets	49,495	43,733
Deferred tax asset	7,491	795
Total current assets	560,950	505,296
Property and equipment at cost, less accumulated depreciation of \$2,649 and \$1,296 at December 29, 2006 and March 31, 2006, respectively	11,238	8,769
Other assets:		
Goodwill	420,180	420,180
Tradename	18,318	18,318
Customer-related intangibles, net of accumulated amortization of \$72,750 and \$43,471 at December 29, 2006 and March 31, 2006, respectively	217,631	246,910
Deferred financing costs, net of accumulated amortization of \$5,428 and \$3,261 at December 29, 2006 and March 31, 2006, respectively	14,955	17,469
Other intangibles, net of accumulated amortization of \$6,450 and \$3,671 at December 29, 2006 and March 31, 2006, respectively	6,743	7,453
Deferred income taxes	12,938	11,518
Other assets	1,918	3,176
Total other assets	692,683	725,024
Total assets	\$ 1,264,871	\$ 1,239,089
Liabilities and Shareholders' Equity		
Current liabilities:		
Current portion of long-term debt	\$ 3,450	\$ 2,588
Current portion of other long-term liabilities	301	
Accounts payable and accrued expenses	125,936	143,668
Accrued payroll and employee costs	78,876	65,586
Other accrued liabilities	55,240	33,845
Income taxes payable	7,648	8,280
Total current liabilities	271,451	253,967
Long-term debt less current portion	628,407	658,963
Other long-term liabilities	5,742	
Shares subject to mandatory redemption Series A preferred stock, stated value \$195,550; 350,000 shares authorized; 190,550 shares issued and outstanding; redemption value of \$219,821 at March 31, 2006; and no shares outstanding at December 29, 2006		219,821
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, \$0.01 par value 50,000 shares authorized; no shares outstanding		
Common stock, \$0.01 par value 232,000 shares and 32,000 shares authorized; 57,000 shares and 32,000 shares issued and outstanding at December 29, 2006 and March 31, 2006, respectively	570	320
Additional paid-in capital	350,832	102,097
Retained earnings	8,097	4,139
Accumulated other comprehensive loss	(228)	(218)
Total shareholders' equity	359,271	106,338
Total liabilities and shareholders' equity	\$ 1,264,871	\$ 1,239,089

See notes to condensed consolidated financial statements.

DYNCORP INTERNATIONAL INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

FOR THE THREE AND NINE MONTHS ENDED DECEMBER 29, 2006 AND DECEMBER 30, 2005

(In thousands, except per share data)

	For the Three Months Ended Dec. 29, 2006 (unaudited)	Dec. 30, 2005	For the Nine Months Ended Dec. 29, 2006 (unaudited)	Dec. 30, 2005
Revenues	\$ 517,539	\$ 553,561	\$ 1,529,944	\$ 1,418,245
Costs of services (excluding depreciation and amortization disclosed below)	449,680	498,482	1,343,447	1,262,074
Selling, general and administrative	24,949	21,013	82,906	59,874
Depreciation and amortization	10,656	10,563	33,005	32,763
Operating income	32,254	23,503	70,586	63,534
Other expense (income):				
Interest expense	14,554	14,595	44,057	42,278
Interest on mandatory redeemable shares		5,903	3,002	14,149
Loss on debt extinguishment and preferred stock			9,201	
(Income) loss from joint ventures	(1,000)	40	(1,323)	181
Interest income	(534)	(112)	(1,094)	(166)
Income before income taxes	19,234	3,077	16,743	7,092
Provision for income taxes	7,640	1,444	8,646	5,607
Net income	\$ 11,594	\$ 1,633	\$ 8,097	\$ 1,485
Earnings per common share:				
Basic and diluted	\$ 0.20	\$ 0.05	\$ 0.15	\$ 0.05
Average common shares outstanding:				
Basic and diluted	57,000	32,000	53,978	32,000

See notes to condensed consolidated financial statements.

DYNCORP INTERNATIONAL INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE MONTHS ENDED DECEMBER 29, 2006 AND DECEMBER 30, 2005

(In thousands)

	For the Nine Months Ended	
	Dec. 29, 2006 (unaudited)	Dec. 30, 2005
Cash flows from operating activities:		
Net income	\$ 8,097	\$ 1,485
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	34,654	33,390
Premium paid on redemption of senior subordinated notes	2,657	
Premium paid on redemption of preferred stock	5,717	
Deferred financing cost amortization	3,154	2,141
Non-cash interest expense (redeemable preferred stock dividend)		14,149
(Recovery) provision for losses on accounts receivable	(4,679)	683
Income from equity joint ventures	(951)	81
Deferred income taxes	(8,116)	(6,187)
Compensation expense related to Class B equity participation	1,471	998
Changes in current assets and liabilities:		
Accounts receivable	(3,754)	30,862
Prepaid expenses and other current assets	(166)	(3,058)
Accounts payable and other accrued liabilities	12,008	(23,283)
Redeemable preferred stock dividend	(3,695)	
Income taxes payable	(610)	2,901
Net cash provided by operating activities	45,787	54,162
Cash flows from investing activities:		
Purchase of property and equipment	(3,679)	(1,338)
Proceeds from sale of property and equipment		11
Payment for computer software upgrade	(2,068)	(2,153)
Other assets	374	(58)
Net cash used in investing activities	(5,373)	(3,538)
Cash flows from financing activities:		
Proceeds from equity offering, net	346,446	
Redemption of preferred stock	(216,126)	
Special dividend	(100,000)	
Premium paid on redemption of senior subordinated notes	(2,657)	
Premium paid on redemption of preferred stock	(5,717)	
Payment of deferred financing costs	(640)	(1,225)
Borrowings related to prepaid insurance, net	2,737	
Payment on acquisition debt		(2,587)
Payments on credit facility	(29,694)	(35,000)
Purchase of interest rate cap		(483)
Net cash used in financing activities	(5,651)	(39,295)
Net increase in cash and cash equivalents	34,763	11,329
Cash and cash equivalents, beginning of period	20,573	13,474
Cash and cash equivalents, end of period	\$ 55,336	\$ 24,803

See notes to condensed consolidated financial statements.

DYNCORP INTERNATIONAL INC.

CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY

FOR THE NINE MONTHS ENDED DECEMBER 29, 2006

(In thousands)

(Unaudited)

	Common Stock		Additional	Retained	Accumulated	
	Shares	Amount	Paid-In	(Deficit)	Other	Total
			Capital	Earnings	Loss	
Balance at March 31, 2006	32,000	\$ 320	\$ 102,097	\$ 4,139	\$ (218)	\$ 106,338
Comprehensive income:						
Net income				8,097		8,097
Interest rate cap					(41)	(41)
Currency translation adjustment					31	31
Comprehensive income				8,097	(10)	8,087
Equity offering, net	25,000	250	343,125			343,375
Mandatory dividend on Class B common stock			(95,861)	(4,139)		(100,000)
Deferred compensation expense on Class B equity of DIV Holding LLC			1,471			1,471
Balance at December 29, 2006	57,000	\$ 570	\$ 350,832	\$ 8,097	\$ (228)	\$ 359,271

See notes to condensed consolidated financial statements.

DYNCORP INTERNATIONAL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(In thousands, except per share data)

Note 1 Description of Business and Organization, Basis of Presentation and Principles of Consolidation

Description of Business and Organization

DynCorp International Inc., through its subsidiaries (together, the Company), provides defense and technical services and government outsourced solutions primarily to U.S. government agencies throughout the United States and internationally. Key offerings include aviation services, such as maintenance and related support, as well as base maintenance/operations and personal and physical security services. Primary customers include the U.S. Departments of Defense and State, but also include other government agencies, foreign governments and commercial customers.

On February 11, 2005, Computer Sciences Corporation and DynCorp, the Company's former parent, sold DynCorp International LLC to DynCorp International Inc., a newly formed entity controlled by The Veritas Capital Fund II, L.P. and its affiliates (Veritas Capital). The Company has no operations independent of DynCorp International LLC. The primary reason for the Company's acquisition of DynCorp International LLC (the 2005 Acquisition) and the most significant factor contributing to the goodwill value is the Company's ability to leverage its infrastructure and management expertise in addressing the government outsourcing trend. All significant intercompany balances and transactions were eliminated.

During the third quarter of fiscal year 2007, the Company renamed its two reporting segments as follows: (i) International Technical Services changed to Government Services; and (ii) Field Technical Services changed to Maintenance and Technical Support Services. See note 12 for a description of service offerings in the two reporting segments.

Equity Offering

On May 9, 2006, the Company consummated an equity offering of 25,000 shares of its Class A common stock, par value \$0.01 per share, at a price of \$15.00 per share (the Equity Offering), less the underwriters' discount of 6% per share. On May 4, 2006, the Class A common stock listed on the New York Stock Exchange under the symbol DCP. The gross proceeds from the Equity Offering of \$375,000, together with cash on hand, were used: (i) to redeem all of the Company's outstanding preferred stock, of which \$222,823 in stated amount, including accrued and unpaid dividends thereon, was outstanding as of May 9, 2006; (ii) to pay a special Class B distribution in the amount of \$100,000, representing a return of capital of \$95,861 to DIV Holding LLC, the holder of the Company's common stock; (iii) to redeem \$27,968 of the Company's senior subordinated notes on June 8, 2006; (iv) to pay prepayment penalties of \$8,374, \$5,717 of which represented prepayment penalties on the Company's preferred stock and \$2,657 of which represented prepayment penalties on the Company's senior subordinated notes; and (v) to pay transaction expenses of approximately \$35,000, including an underwriters' commission of \$22,500, a fee of \$5,000 to Veritas Capital and \$7,500 of miscellaneous fees and expenses related to the Equity Offering.

Basis of Presentation

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 U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X.

DYNCORP INTERNATIONAL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)
(In thousands, except per share data)

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 Annual Report (File No. 001-0824791) on Form 10-K, filed with the Securities and Exchange Commission (the "SEC") on June 29, 2006.

In the opinion of management, all adjustments necessary to fairly present the Company's financial position at December 29, 2006 and March 31, 2006, the results of operations for the three and nine months ended December 29, 2006 and December 30, 2005, and cash flows for the nine months ended December 29, 2006 and December 30, 2005, have been included. The results of operations for the three and nine months ended December 29, 2006 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.

The Company reports its results on a 52/53 week fiscal year with the fiscal year ending on the Friday closest to March 31. The three months ended December 29, 2006 was a 13-week period from September 30, 2006 to December 29, 2006. The three months ended December 30, 2005 was a 13-week period from October 1, 2005 to December 30, 2005. The nine months ended December 29, 2006 was a 39-week period from April 1, 2006 to December 29, 2006. The nine months ended December 30, 2005 was a 39-week period from April 2, 2005 to December 30, 2005.

Principles of Consolidation

All intercompany transactions and balances have been eliminated in consolidation. 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. The Company has no investments in business entities of less than 20% ownership interest.

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 December 29, 2006 and are accounted for by the equity method. For all of the entities listed below, the Company has the right to elect half of the board of directors (the "Board of Directors") or other management body. Economic rights are indicated by the ownership percentages listed below.

Dyn Al-Rushaid Services LLC	50.0 %
DynCorp-Hiberna Ltd.	50.0 %
DynEgypt LLC	50.0 %
DynPuertoRico Corporation	49.9 %
Contingency Response Services LLC	45.0 %
Partnership for Temporary Housing LLC	40.0 %
Babcock DynCorp Limited	40.0 %

DYNCORP INTERNATIONAL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)
(In thousands, except per share data)

The following table sets forth the Company's ownership in a joint venture that is consolidated into the Company's financial statements as of December 29, 2006. For the entity listed below, the Company has the right to elect half of the Board of Directors or other management body.

Global Linguist Solutions LLC	51.0 %
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Recent Accounting Pronouncements

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 (SAB 108), *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*, to address diversity in practice in quantifying financial statement misstatements. SAB No. 108 requires the Company to quantify misstatements based on their impact on each of its consolidated financial statements and related disclosures. SAB No. 108 is effective as of the end of fiscal 2007, allowing a one-time transitional cumulative effect adjustment to retained earnings as of April 1, 2006 for errors that were not previously deemed material, but are material under the guidance in SAB No. 108. The Company is currently evaluating the impact SAB No. 108 will have on its consolidated financial statements.

In September 2006, the Financial Accounting Standards Board (the FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. This statement does not require any new fair value measurements; rather, it applies under other accounting pronouncements that require or permit fair value measurements. The provisions of this statement are to be applied prospectively as of the beginning of the fiscal year in which this statement is initially applied, with any transition adjustment recognized as a cumulative-effect adjustment to the opening balance of retained earnings. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently evaluating the impact of adopting SFAS No. 157 on its consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting and reporting for income taxes recognized in accordance with SFAS No. 109, *Accounting for Income Taxes*. This interpretation prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. The requirements of FIN 48 are effective for fiscal periods beginning after December 15, 2006. The Company is currently evaluating the impact of FIN 48 on its consolidated financial statements.

On May 18, 2006, the State of Texas passed a bill replacing the current franchise tax with a new margin tax that will go into effect on January 1, 2008. The Company estimates that the new margin tax will not have a significant impact on tax expense or deferred tax assets and liabilities.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections - a replacement of APB Opinion No. 20 and FASB Statement No. 3*. SFAS No. 154 provides guidance on the accounting for, and reporting of, accounting changes and error corrections. It establishes, unless impracticable, retrospective application as the required method for reporting a change in accounting

DYNCORP INTERNATIONAL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)
(In thousands, except per share data)

principle in the absence of explicit transition requirements specific to the newly adopted accounting principle. SFAS No. 154 also provides guidance for determining whether retrospective application of a change in accounting principle is impracticable and for reporting such a change when retrospective application is impracticable. The provisions of SFAS No. 154 are effective for accounting changes and corrections of errors made in fiscal periods beginning after December 15, 2005. The adoption of SFAS No. 154 did not have any effect on the Company's consolidated financial statements.

Reclassification

The per share data as of March 31, 2006 has been adjusted to reflect the 64-to-1 stock split and conversion of the Class B common stock to Class A common stock as a result of the Equity Offering.

Note 2 Receivables

Receivables consist of the following:

	Dec. 29, 2006	March 31, 2006
Billed	\$ 213,256	\$ 188,458
Unbilled	233,479	248,994
Unbilled related party		495
	\$ 446,735	\$ 437,947

Unbilled receivables consist of costs and fees billable on contract completion or other specified events, the majority of which is expected to be billed and collected within sixty days. Unbilled receivables include revenue recognized 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 quarter. At December 29, 2006 and March 31, 2006, unbilled receivables included \$29,210 and \$31,303, respectively, related to this type of unbilled receivable balance. In addition, unbilled receivables includes amounts related to contract retentions that are billed when the Company has negotiated final indirect rates with the U.S. government and, once billed, are subject to audit and approval by outside third parties. Consequently, the timing of collection of retention balances of \$626 and \$10 as of December 29, 2006 and March 31, 2006, respectively, is outside the Company's control. Based on the Company's historical experience, the majority of the retention balance is expected to be collected beyond one year.

DYNCORP INTERNATIONAL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)
(In thousands, except per share data)

Note 3 Other Intangible Assets and Other Assets

A summary of amortizable intangible assets is as follows:

	December 29, 2006			
	Weighted- Average Amortization Period	Gross Carrying Value	Accumulated Amortization	Net
Customer-related intangible assets	8.5	\$ 290,381	\$ (72,750)	\$ 217,631
Deferred financing cost	7.0	20,383	(5,428)	14,955
Other	4.2	13,193	(6,450)	6,743
		\$ 323,957	\$ (84,628)	\$ 239,329

	March 31, 2006			
	Weighted- Average Amortization Period	Gross Carrying Value	Accumulated Amortization	Net
Customer-related intangible assets	8.5	\$ 290,381	\$ (43,471)	\$ 246,910
Deferred financing cost	7.1	20,730	(3,261)	17,469
Other	4.1	11,124	(3,671)	7,453
		\$ 322,235	\$ (50,403)	\$ 271,832

Amortization expense for customer-related and other intangibles was \$10,353 and \$10,009 for the three months ended December 29, 2006 and December 30, 2005, respectively. Amortization expense for customer-related and other intangibles was \$32,062 and \$31,143 for the nine months ended December 29, 2006 and December 30, 2005, respectively. Estimated amortization related to intangible assets at December 29, 2006 for fiscal years 2007 through 2011 is as follows: \$11,050, \$42,756, \$39,972, \$39,580 and \$35,407, respectively.

Deferred financing cost is amortized through interest expense. Amortization related to deferred financing costs was \$812 and \$821 for the three months ended December 29, 2006 and December 30, 2005, respectively. Amortization related to deferred financing costs was \$2,327 and \$2,141 for the nine months ended December 29, 2006 and December 30, 2005, respectively.

A summary of other assets is as follows:

	Dec. 29, 2006	March 31, 2006
Other assets:		
Investment in affiliates	\$ 1,547	\$ 911
Deferred offering costs		1,940
Other	371	325
	\$ 1,918	\$ 3,176

DYNCORP INTERNATIONAL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)
(In thousands, except per share data)

Note 4 Cash Flows

Cash payments for interest on indebtedness were \$34,938 and \$35,918 for the nine months ended December 29, 2006 and December 30, 2005, respectively. Net cash payments for income taxes were \$17,588 and \$8,883 for the nine months ended December 29, 2006 and December 30, 2005, respectively. The Company had non-cash investing activities of \$819 related to property and equipment purchases that were accrued at December 29, 2006. In addition, the Company had non-cash leasehold improvements of \$3,015 related to one lease at December 29, 2006.

Note 5 Derivatives

Derivative financial instruments are recognized as either assets or liabilities in the balance sheet and carried at fair value. Gains or losses on derivatives designated as cash flow hedges are initially reported as a component of other comprehensive income and later classified into earnings in the period in which the hedged item also affects earnings.

The Company entered into an interest rate cap effective May 4, 2005 and paid a premium of \$483. The interest rate cap has the effect of placing a ceiling on the interest expense the Company could incur on \$172,500 of variable debt indexed to the London Interbank Offered Rate at 6.5% plus the applicable floating spread (2.25% at December 29, 2006) as defined by the Company's senior secured credit facility agreement. The interest rate cap has been designated by the Company as a cash flow hedge. As of December 29, 2006, the fair value of the interest rate cap was \$11, which was recorded in the accompanying condensed consolidated balance sheet in other assets with the reduction in fair value, net of tax, recorded in equity as other comprehensive loss.

Note 6 Significant Changes in Indebtedness

The table below presents significant changes in the amounts of senior subordinated notes and similar debt:

	9.5% Senior Subordinated Notes	Senior Secured Credit Facility Term Loan	Revolver	Total
Balance at March 31, 2006	\$ 320,000	\$ 341,551	\$	\$ 661,551
Payments	(27,968)	(1,726)		(29,694)
Balance at December 29, 2006	\$ 292,032	\$ 339,825	\$	\$ 631,857

On June 9, 2006, in connection with the Equity Offering, the Company redeemed \$27,968 of the \$320,000 aggregate principal amount of the senior subordinated notes. The Company also paid \$834 in accrued interest through the redemption date and a prepayment penalty of \$2,657 related to the senior subordinated notes.

In connection with the Equity Offering, the Company recognized an \$827 loss related to the write-off of a portion of the previously capitalized loan cost for the senior subordinated notes.

On June 28, 2006, the Company, through its operating company, DynCorp International LLC, entered into a second amendment and waiver of the Company's senior secured credit facility, dated February 11,

DYNCORP INTERNATIONAL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)
(In thousands, except per share data)

2005, as amended on January 9, 2006. The second amendment and waiver provided for a senior secured credit facility of \$431,551, representing a \$90,000 revolver and a \$341,551 outstanding term loan. The second amendment and waiver also provided for the following, among other things: (i) decreased the interest rate spread applicable to the term loan under the Company's senior secured credit facility; (ii) permits the Company to request an increase in its revolving credit facility by an aggregate amount of up to \$30,000, subject to the Company obtaining commitments from existing and/or new lenders; (iii) increases the amount of capital expenditures permitted under the Company's senior secured credit facility from \$4,000 per fiscal year to \$8,000 per fiscal year; (iv) increases the amount of capitalized leases permitted under the Company's senior secured credit facility from \$10,000 per fiscal year to \$25,000 per fiscal year; (v) allows for the payment of dividends and the repurchase of the Company's capital stock in the amount of \$10,000, plus, if the Company's leverage ratio (as defined in the senior secured credit facility) is below 3.25:1.00, 25% of the Company's excess cash flow (as defined in the senior secured credit facility) for each fiscal year; and (vi) provides for the first excess cash flow payment, as defined by the senior secured credit facility, to commence on the Company's fiscal year that ends on March 30, 2007.

In November 2006, the Company obtained additional commitments from two new lenders which increased the revolving credit facility to \$103,000. On December 29, 2006, the Company had \$93,899 available under the senior secured credit facility. This amount gives effect to \$9,101 in outstanding letters of credit as of December 29, 2006.

Note 7 Class B Equity Participation

During fiscal year ended March 31, 2006, certain members of management and the outside directors were granted a participating interest in the profits through a plan that granted them Class B interests in an affiliate, DIV Holding LLC. DIV Holding LLC conducts no operations and was established for the primary purpose of holding the equity of the Company. At December 29, 2006, the aggregate individual grants were approximately 5.2% of the Class B interests of DIV Holding LLC. Pursuant to the terms of the operating agreement governing DIV Holding LLC, the holders of Class B interests are entitled to receive up to 7.5% of all distributions made by DIV Holding LLC after the holders of the Class A interests in DIV Holding LLC have received a return of their invested capital, provided that the holders of the Class A interests have received an 8.0% per annum internal rate of return (compounded annually) on their invested capital. The Class B interests are subject to a five-year vesting schedule with any unvested interest reverting to the holders of Class A interests in the event the Class B interests are forfeited or repurchased. The fair value of the Class B interests granted to certain members of management and the outside directors was determined to be \$8,494 as of the effective date of each grant. In accordance with SFAS No. 123(R) *Share-Based Payment*, the Company records compensation expense based on the fair value as of the effective date of each grant and commensurate with its graded vesting schedules. For the nine months ended December 29, 2006, the Company recognized non-cash compensation expense of \$1,471.

Assuming each grant fully vests, the Company will recognize additional non-cash compensation expense as follows:

FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
\$658	\$2,065	\$1,195	\$ 567	\$120

DYNCORP INTERNATIONAL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)
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Note 8 Shareholders Equity

On May 3, 2006, the Company amended and restated its certificate of incorporation with the Secretary of State of the State of Delaware. The amended and restated certificate of incorporation authorized the Company to issue up to:

- (1) 50,000 shares of preferred stock, par value \$0.01 per share; and
- (2) 232,000 shares of Class A common stock, par value \$0.01 per share.

The new shares of preferred and common stock have rights identical to the preferred stock and the Class A common stock of the Company outstanding immediately before filing the amendment. At December 29, 2006, the Company had no preferred stock outstanding and 57,000 shares of Class A common stock outstanding.

Stock Split

The Company authorized a 64-to-1 stock split for the 500 shares of the Company's Class B common stock outstanding as of May 3, 2006.

Mandatory Conversion of the Class B common stock

Upon the payment of mandatory dividends to the holders of the Company's Class B common stock and the expiration of the underwriters overallotment option from the Equity Offering, each share of Class B common stock then issued and outstanding was automatically converted into one fully paid and nonassessable share of Class A common stock.

Mandatory Dividend

Prior to the closing of the Equity Offering, the Board of Directors declared a mandatory dividend, payable in cash and subject to the consummation of the Equity Offering, to the holders of record on May 3, 2006 of the then-outstanding shares of the Company's Class B common stock, in an aggregate amount of \$100,000. The Company completed the Equity Offering and paid the mandatory dividend on May 9, 2006.

Note 9 Shares Subject to Mandatory Redemption

In connection with the Equity Offering, the Company redeemed all of its outstanding \$0.01 par value Series A-1 and Series A-2 preferred stock for \$222,823, including accrued and unpaid dividends as of the date of redemption of May 9, 2006. In addition, the Company paid \$5,717 in prepayment penalties for the early redemption of the preferred stock.

DYNCORP INTERNATIONAL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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Note 10 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. The Company did not have any anti-dilutive stock. The following table reconciles the numerators and denominators used in the computations of both basic and diluted earnings per share (EPS):

	For the Three Months Ended Dec. 29, 2006	Dec. 30, 2005	For the Nine Months Ended Dec. 29, 2006	Dec. 30, 2005
Basic and dilutive EPS:				
Numerator:				
Net income	\$ 11,594	\$ 1,633	\$ 8,097	\$ 1,485
Denominator:				
Average common shares basic and dilutive	57,000	32,000	53,978	32,000
Basic and dilutive EPS	\$ 0.20	\$ 0.05	\$ 0.15	\$ 0.05

Note 11 Commitments, Contingencies and Litigation

Commitments

The Company has operating leases for the use of certain property and equipment. Operating leases are noncancelable, 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 property are subject to annual escalations for increases in utilities and property taxes. Lease rental expense amounted to \$6,862 and \$19,124 for the three months ended December 29, 2006 and December 30, 2005, respectively. Lease rental expense amounted to \$39,232 and \$39,544 for the nine months ended December 29, 2006 and December 30, 2005, respectively.

Minimum fixed rentals required for the next five years and thereafter under operating leases in effect at December 29, 2006 are as follows:

Fiscal Year	Real Estate	Equipment
2007	\$ 951	\$ 211
2008	3,465	751
2009	2,432	55
2010	2,186	
2011	2,186	
Thereafter	12,023	
	\$ 23,243	\$ 1,017

The Company has no significant long-term purchase agreements with service providers.

DYNCORP INTERNATIONAL INC.
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Contingencies

The primary financial instruments that potentially subject the Company to concentrations of credit risk are accounts receivable. Departments and agencies of the U.S. federal government account for all but minor portions of the Company's customer base, thereby minimizing credit risk. Furthermore, the Company continuously reviews all accounts receivable and records provisions for doubtful accounts as needed.

Litigation

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, liability. The Company has recorded its best estimate of the aggregate liability that will result from these matters and believes that these matters are adequately reserved. While it is not possible to predict with certainty the outcome of litigation, it is the opinion of the Company's management, based in part upon opinions of counsel, insurance in force and the facts currently known, that liabilities in excess of those recorded, if any, arising from such matters would not have a material adverse effect on the results of operations, consolidated financial condition or liquidity of the Company over the long term.

In addition, the Company is occasionally the subject of investigations by various agencies of the U.S. government. Such investigations, whether related to 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 the Company, or could lead to suspension or debarment from future U.S. government contracting. In management's opinion, there are no outstanding issues of this nature at December 29, 2006 that will have a material adverse effect on the Company's consolidated financial condition, results of operations or liquidity.

On January 30, 2007, the Special Inspector General for Iraq Reconstruction (SIGIR) issued a report on Company contract number S-LMAQM-04-C-0030, Task Order 0338, concerning the Iraqi Police Training Program. Among other items, the report raises questions about the Company's work under Task Order 0338 to establish a residential camp in Baghdad to house training personnel. Specifically, the SIGIR report recommends that the Director, Office of Acquisition Management, U.S. Department of State (State Department), seek reimbursement from the Company of \$4.2 million paid by the State Department for work that the SIGIR maintains was not contractually authorized. In addition, the SIGIR report recommends that the State Department request the Defense Contract Audit Agency to review two Company invoices totaling \$19.1 million. In management's opinion and based on facts currently known, the above described matters raised in the SIGIR report will not have a material adverse effect on the Company's consolidated financial condition, results of operations or liquidity.

On September 11, 2001, a class action lawsuit seeking \$100,000 on behalf of approximately 10,000 citizens of Ecuador was filed against DynCorp International LLC and several of its former affiliates in the U.S. District Court for the District of Columbia. The action alleges personal injury, property damage and wrongful death as a consequence of the spraying of narcotic plant crops along the Colombian border adjacent to Ecuador. The spraying operations are conducted under a Department of State contract in cooperation with the Colombian government. The terms of the Department of State contract provide that

DYNCORP INTERNATIONAL INC.

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the Department of State will indemnify DynCorp International LLC against third-party liabilities arising out of the contract, subject to available funding. 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.

On December 4, 2006, a lawsuit was served, and amended on December 29, 2006, on behalf of 1,663 citizens of the Ecuadorian provinces of Esmeraldas and Sucumbios, 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. The action 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, as a consequence of the spraying of narcotic plant crops along the Colombian border adjacent to Ecuador. The spraying operations are the same operations which are the subject of the above-mentioned litigation and are conducted under a Department of State contract in cooperation with the Colombian government. As mentioned above, the terms of the Department of State contract provide that the Department of State will indemnify DynCorp International LLC against third-party liabilities arising out of the contract, subject to available funding.

On December 29, 2006, a lawsuit was served on behalf of the Providence of Sucumbios in Ecuador, 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. The action alleges violations of Ecuadorian law, international law, and the statutes and common law of Florida, including negligence, trespass, and nuisance, as a consequence of the spraying of narcotic plant crops along the Colombian border adjacent to Ecuador. The spraying operations are the same operations which are the subject of the litigation described in the immediately preceding paragraph. The relevant Department of State contract provides indemnification to DynCorp International LLC against third-party liabilities arising out of the contract, subject to available funding.

On May 29, 2003, Gloria Longest, a former accounting manager for the Company, filed suit against DynCorp International LLC under the False Claims Act and the Florida Whistleblower Statute, alleging that DynCorp International LLC submitted false claims to the government under the International Narcotics and Law Enforcement Affairs contract with the Department of State. The action, titled *U.S. ex rel. Longest v. DynCorp and DynCorp International LLC*, was filed in the U.S. District Court for the Middle District of Florida under seal. The case was unsealed in 2005, and the Company learned of its existence on August 15, 2005 when it was served with the complaint. After conducting an investigation of the allegations made by the plaintiff, the U.S. government did not join the action. The complaint does not demand any specific monetary damages; however, in the event that a court decides against the Company in this lawsuit, that result could have a material adverse effect on the Company's operating performance.

Note 12 Segment Information

The Company is organized into two reporting segments. During the third quarter of fiscal year 2007, the Company renamed its two reporting segments as follows: (i) International Technical Services to Government Services (IGSS); and (ii) Field Technical Services to Maintenance and Technical Support Services (MTSS). MTSS primarily offers aviation services, including maintenance and modifications, training, aftermarket logistics support, avionics upgrades, field installations, and aircraft operations and

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training. GS primarily offers base maintenance/operations and personal and physical security services. The Company provides services domestically and in foreign countries under contracts with the U.S. government and some foreign customers. The risks associated with the Company's foreign operations relating to foreign currency fluctuation and political and economic conditions in foreign countries have not had a significant negative impact on the Company. The Company operates principally within a regulatory environment subject to governmental contracting and accounting requirements, including Federal Acquisition Regulations, Cost Accounting Standards and audits by various U.S. federal agencies.

The Company's MTSS operating segment provides long-term aviation services and engineering and logistics support, ranging from daily fleet maintenance to extensive modification and overhauls on aircraft, weapons systems and support equipment. MTSS generates revenue under long-term contracts that are typically three to ten years in duration. Based on revenues, Contract Field Teams is the most significant program in the MTSS operating segment. The Company and its predecessors have participated in this program for 54 consecutive years. This program deploys highly mobile, quick-response field teams to customer locations worldwide to supplement the Company's customers' workforce, including generally providing mission support to aircraft and weapons systems in addition to depot-level repair.

The Company's GS operating segment primarily provides outsourced law enforcement training, drug eradication, global logistics, base operations and personal and physical security services to government and commercial customers in foreign jurisdictions. The GS operating segment has witnessed strong growth as a part of the Department of State's outsourced law enforcement training in the Middle East. The Company was awarded a new Civilian Police contract, which expanded the existing Civilian Police program in place since 1994. As of September 29, 2006, the Company had deployed civilian police officers from the United States to two countries to train and offer logistics support to the local police and assist them with infrastructure and reconstruction.

The DynCorp International Home Office component represents assets not included in a reporting segment and is primarily comprised of the following: (i) severance-related costs; (ii) bonuses paid to certain members of management related to the Equity Offering; (iii) deferred compensation expense related to the Class B equity interest; and (iv) income or loss from joint ventures.

The table below presents selected financial information for the respective periods, for the two reportable segments and for financial items that cannot be allocated to either operating segment:

	Maintenance And Technical Support Services	Government Services	DynCorp International Home Office	Total
For the Three Months Ended December 29, 2006:				
Revenues	\$ 179,838	\$ 337,701	\$	\$ 517,539
Earnings before interest and taxes	272	34,361	(845)	33,788
Depreciation and amortization	3,398	7,690	51	11,139
For the Three Months Ended December 30, 2005:				
Revenues	\$ 179,592	\$ 373,969	\$	\$ 553,561
Earnings before interest and taxes	3,635	20,654	(714)	23,575
Depreciation and amortization	2,563	7,540	672	10,775

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	Maintenance and Technical Support Services	Government Services	DynCorp International Home Office	Total
For the Nine Months Ended December 29, 2006:				
Revenues	\$ 528,029	\$ 1,001,915	\$	\$ 1,529,944
Earnings before interest and taxes	7,444	72,537	(6,978)	73,003
Depreciation and amortization	9,376	23,192	2,086	34,654
Assets	331,731	843,704	89,436	1,264,871
For the Nine Months Ended December 30, 2005:				
Revenues	\$ 521,963	\$ 896,282	\$	\$ 1,418,245
Earnings before interest and taxes	17,156	47,033	(670)	63,519
Depreciation and amortization	8,400	23,175	1,815	33,390

The Company evaluates segment performance based primarily on the non-GAAP measure of earnings before interest and taxes (EBIT), which includes the effects of corporate expense allocations. EBIT is a non-GAAP measure that includes operating income, interest income and income (loss) from joint ventures. Items that the Company does not include in EBIT are interest expense and income taxes, each of which the Company evaluates on a consolidated level. The Company's management believes EBIT is a useful measurement of the Company's performance because it provides information that can be used to evaluate the effectiveness of the Company's business from an operational perspective, exclusive of the costs to finance those activities and exclusive of income taxes, neither of which is directly relevant to the efficiency of those operations.

EBIT should not be considered an alternative to, or a more meaningful indicator of the Company's operating performance than, operating income or net income as determined in accordance with GAAP. In addition, EBIT may not be comparable to a similarly titled measure of another company. A reconciliation of earnings before interest and taxes to net income is as follows:

	For the Three Months Ended		For the Nine Months Ended	
	Dec. 29, 2006	Dec. 30, 2005	Dec. 29, 2006	Dec. 30, 2005
Earnings before interest and taxes	\$ 33,788	\$ 23,575	\$ 73,003	\$ 63,519
Interest expense	14,554	20,498	47,059	56,427
Loss on debt extinguishment and preferred stock			9,201	
Provision for income taxes	7,640	1,444	8,646	5,607
Net income	\$ 11,594	\$ 1,633	\$ 8,097	\$ 1,485

* * * * *

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

References to the Company, us or we refer to DynCorp International Inc. and its consolidated subsidiaries. The following discussion and analysis of the Company's financial condition and results of operations should be read in conjunction with the financial statements and the notes thereto contained elsewhere in this report. Certain information contained in the discussion and analysis set forth below includes forward-looking statements that involve risks and uncertainties.

Special Note Regarding Forward-Looking Statements

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. Forward-looking statements involve risks and uncertainties. Without limiting the foregoing, the words believes, thinks, anticipates, plans, expects and similar expressions are intended to identify forward-looking statements. The Company cautions 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, including, without limitation, changes in the demand for services that the Company provides; additional work awarded under the Civilian Police and International Narcotics and Law Enforcement contracts; pursuit of new commercial business in the United States and abroad; activities of competitors; changes in significant operating expenses; changes in availability of capital; general economic and business conditions in the United States; acts of war or terrorist activities; variations in performance of financial markets; estimates of contract values; anticipated revenues from indefinite delivery, indefinite quantity contracts; expected percentages of future revenues represented by fixed-price and time-and-materials contracts; and statements covering our business strategy, those described in Risk Factors and other risks detailed from time to time in the Company's 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. The Company assumes no obligation to update the forward-looking statements.

Overview

Company Background

We provide specialized mission-critical outsourced technical services to civilian and military government agencies. Our specific global expertise is in law enforcement training and support, security services, base operations and aviation services and operations. We also provide logistics support for all of our services. Our predecessors have provided services to numerous U.S. government departments and agencies since 1951. We operated as a separate subsidiary of Computer Sciences Corporation from March 2003 until February 2005. On February 11, 2005, Computer Sciences Corporation and DynCorp sold our Company to DynCorp International Inc., a newly formed entity controlled by Veritas Capital (the 2005 Acquisition).

Segments

During the third quarter of fiscal year 2007, the Company renamed its two reporting segments as follows: (i) International Technical Services changed to Government Services (GS); and (ii) Field Technical Services changed to Maintenance and Technical Support Services (MTSS).

Backlog and New Orders

We track contracted backlog in order to assess our current business development effectiveness and to assist us in forecasting our future business needs and financial performance. Backlog consists of orders and priced options under our contracts. We define contracted backlog as the estimated value of contract modifications received from customers that have not been recognized as revenue. Our backlog consists of funded and unfunded amounts. Funded backlog is based upon amounts actually appropriated by a customer for payment of goods and services less actual revenue recorded as of the measurement date under that appropriation. Unfunded backlog is the actual dollar value of unexercised 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 options may be exercised at the sole discretion of the customer. Historically, it has been our experience that the customer has exercised contract options.

Firm funding for our contracts is usually made for only one year at a time, with the remainder of the years under the contract expressed as 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 generally has funded the option periods of our contracts.

The following table sets forth our contracted backlog (dollars in millions) as of the dates indicated:

	Dec. 30, 2005	March 31, 2006	Dec. 29, 2006
Funded backlog	\$ 1,053	\$ 1,024	\$ 1,248
Unfunded backlog	1,639	1,617	4,553
Total backlog	\$ 2,692	\$ 2,641	\$ 5,801

In December 2006, the Company, through a joint venture named Global Linguist Solutions LLC, was awarded a contract for management of translation and interpretation services in support of Operation Iraqi Freedom. The five-year contract, with a maximum value of \$4.645 billion, was awarded by the Intelligence and Security Command. We are the managing partner of the joint venture with a 51% ownership interest and will consolidate the joint venture in our financial statements. The funded and unfunded amount related to this program of \$49.0 million and \$3.3 billion, respectively, has been included in the table above as of December 29, 2006. However, the incumbent of these services has filed a formal protest with the Government Accountability Office (the GAO), thereby delaying the commencement of the contract. The GAO has until April 2, 2007 to decide whether the awards process was fair. Our backlog and estimated remaining contract value metrics may require future adjustment depending on the outcome of the protest.

New orders represent new contracts, or additional work added under existing contracts, received during the periods presented below (dollars in millions).

	For the Nine Months Ended Dec. 30, 2005	Fiscal Year Ended March 31, 2006	For the Nine Months Ended Dec. 29, 2006
New orders	\$ 2,070	\$ 2,568	\$ 4,696

Estimated Remaining Contract Value

The following table sets forth our estimated remaining contract value (dollars in millions) as of the dates indicated:

	Dec. 30, 2005	March 31, 2006	Dec. 29, 2006
Estimated remaining contract value	\$6,135	\$ 5,727	\$ 8,944

Our estimated remaining contract value represents the backlog plus management's estimate of future revenues under indefinite delivery, indefinite quantity contracts that have not been funded, or award term periods that have not yet been earned. These future revenues would be our estimate of revenue that would occur from the end of currently funded task orders until the end of the indefinite delivery, indefinite quantity contracts. Our estimated remaining contract value is based on our experience under contracts, and we believe our estimates are reasonable. However, there can be no assurance that our existing contracts will result in actual revenues in any particular period or at all. These amounts could vary or even change significantly depending upon government policies, government budgets, appropriations and the outcome of protested contract awards.

Results of Operations

The following table (dollars in thousands) sets forth, for the periods indicated, our historical results of operations:

	For the Three Months Ended				For the Nine Months Ended			
	Dec. 29, 2006	% of Revenue	Dec. 30, 2005	% of Revenue	Dec. 29, 2006	% of Revenue	Dec. 30, 2005	% of Revenue
Revenues:								
Government Services	\$ 337,701	65.3 %	\$ 373,969	67.6 %	\$ 1,001,915	65.5 %	\$ 896,282	63.2 %
Maintenance and Technical Support Services	179,838	34.7	179,592	32.4	528,029	34.5	521,963	36.8
Total revenues	517,539	100.0 %	553,561	100.0 %	1,529,944	100.0 %	1,418,245	100.0 %
Costs of services (excluding depreciation and amortization disclosed below)	449,680	86.9	498,482	90.1	1,343,447	87.8	1,262,074	89.0
Selling, general and administrative expenses	24,949	4.8	21,013	3.8	82,906	5.4	59,874	4.2
Depreciation and amortization	10,656	2.1	10,563	1.9	33,005	2.2	32,763	2.3
Total costs and expenses	485,285	93.8	530,058	95.8	1,459,358	95.4	1,354,711	95.5
Interest expense	14,554	2.8	14,595	2.6	44,057	2.9	42,278	3.0
Interest on mandatory redeemable shares			5,903	1.1	3,002	0.2	14,149	1.0
Loss on debt extinguishment and preferred stock					9,201	0.6		
(Income) loss from joint ventures	(1,000)	(0.2)	40	0.0	(1,323)	(0.1)	181	0.0
Interest income	(534)	(0.1)	(112)	0.0	(1,094)	(0.1)	(166)	0.0
Income before income taxes	19,234	3.7	3,077	0.5	16,743	1.1	7,092	0.5
Provision for income taxes	7,640	1.5	1,444	0.2	8,646	0.6	5,607	0.4
Net income	\$ 11,594	2.2 %	\$ 1,633	0.3 %	\$ 8,097	0.5 %	\$ 1,485	0.1 %

Three Months Ended December 29, 2006 Compared To Three Months Ended December 30, 2005*Consolidated*

Revenues. Total revenues decreased from \$553.6 million for the three months ended December 30, 2005 to \$517.5 million for the three months ended December 29, 2006, a decrease of \$36.1 million or 6.5%. For the three months ended December 29, 2006 and December 30, 2005, approximately 44%, 36% and 20% and approximately 27%, 38% and 35% of our revenues were derived from fixed-price, time-and-materials, and cost-reimbursement contracts, respectively.

Revenues from our GS segment decreased from \$374.0 million for the three months ended December 30, 2005 to \$337.7 million for the three months ended December 29, 2006, a decrease of \$36.3 million or 9.7%. The GS revenue decrease was primarily driven by the conclusion of protective services previously provided in Israel, Haiti, Afghanistan and central Iraq. This reduction of services decreased revenues for the three months ended December 29, 2006 by \$29.8 million, when compared to the three months ended December 30, 2005. Additional factors that contributed to the decrease in revenues are: (i) the ending of services provided in support of Hurricane Katrina relief efforts; and (ii) completion of helicopter refurbishment and upgrades in support of U.S. drug eradication efforts in Afghanistan.

Revenues from our MTSS segment increased from \$179.6 million for the three months ended December 30, 2005 to \$179.8 million for the three months ended December 29, 2006, an increase of \$0.2 million or 0.1%. The increased MTSS revenue was primarily driven by: (i) services provided to the U.S. Air Force under the C-21 Contractor Logistics Support program; and (ii) increased maintenance of military equipment returning from Iraq and Afghanistan. Partially offsetting the revenue increase was a decrease in U.S. government funding for the Army Prepositioned Stocks Afloat program and the conclusion of the Fort Hood domestic aviation contract in July 2006.

Costs of services. Costs 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 decreased from \$498.5 million for the three months ended December 30, 2005 to \$450.0 million for the three months ended December 29, 2006, a decrease of \$48.5 million or 9.7%. As a percentage of revenue, costs of services decreased from 90.1% in the three months ended December 30, 2005 to 86.9% for the three months ended December 29, 2006. The factors contributing to the decrease in cost of services as a percentage of revenue were: (i) a higher mix of fixed-price and time-and-material contracts in the current quarter; (ii) improved profitability under fixed-price contracts within our GS segment resulting from strong operational performance and contract changes; and (iii) a contract modification for construction efforts in Afghanistan completed in earlier periods.

Selling, general and administrative expenses. Selling, general and administrative expenses primarily relate to functions such as management, legal, financial accounting, contracts and administration, human resources, management information systems, purchasing and business development. Selling, general and administrative expenses for the three months ended December 30, 2005 were \$21.0 million and increased to \$24.9 million for the three months ended December 29, 2006, an increase of \$3.9 million or 18.6%. In addition, as a percentage of revenue, selling, general and administrative expenses increased from 3.8% for the three months ended December 30, 2005 to 4.8% for the three months ended December 29, 2006. Factors contributing to higher selling, general and administrative expenses for the three months ended December 29, 2006 include: (i) an increase of \$2.4 million in business development costs; (ii) an increase of \$0.8 million in legal costs; and (iii) an increase of \$1.0 million in severance expense related to the departure of a senior executive.

Depreciation and amortization. Depreciation and amortization increased slightly from \$10.6 million for the three months ended December 30, 2005 to \$10.7 million for the three months ended December 29, 2006.

Interest expense. Interest expense was \$14.6 million for the three months ended December 30, 2005 and December 29, 2006. The interest expense incurred relates to our senior secured credit facility, revolving credit facility, senior subordinated notes and amortization of deferred financing fees. Interest expense has remained consistent compared to the same period last year despite an increase in variable interest rates applicable to the senior secured credit facility. Partially offsetting the higher interest rate in interest expense was lower interest incurred on the senior subordinated notes, which have a fixed interest rate of 9.5%, due to the partial redemption in connection with the Equity Offering.

Interest on mandatory redeemable shares. Interest on mandatory redeemable shares, or preferred stock, was \$5.9 million for the three months ended December 30, 2005. All of our outstanding preferred stock was redeemed in connection with our Equity Offering on May 9, 2006. Therefore, we had no comparable expense for the three months ended December 29, 2006.

Income tax expense. We had income tax expense for the three months ended December 29, 2006 of \$7.6 million, an increase of \$6.2 million from income tax expense of \$1.4 million for the three months ended December 30, 2005. The increase is primarily the result of higher income before tax as compared to the three months ended December 30, 2005. We had an effective tax rate of 39.7% for the three months ended December 29, 2006. Included in our effective tax rate is a permanent difference related to interest on mandatory redeemable shares occurring during the first fiscal quarter of 2007. Our effective tax rate before consideration of this permanent difference was 36.3%.

Results by Segment

We evaluate segment performance based primarily on the non-GAAP measure of EBIT, which includes the effects of corporate expense allocations. EBIT is a non-GAAP measure that includes operating income, other income and income (loss) from joint ventures. Items that we do not include in EBIT are interest expense and income taxes, each of which we evaluate on a consolidated level. We believe EBIT is a useful measurement of our performance because it provides information that can be used to evaluate the effectiveness of our businesses from an operational perspective, exclusive of the costs to finance those activities and exclusive of income taxes, neither of which is directly relevant to the efficiency of those operations.

EBIT should not be considered an alternative to, or a more meaningful indicator of our operating performance than, operating income or net income as determined in accordance with GAAP. In addition, our EBIT may not be comparable to a similarly titled measure of another company.

The following table (dollars in thousands) sets forth earnings before interest and taxes for our GS and MTSS operating segments, both in dollars and as a percentage of segment specific revenue, for the three months ended December 29, 2006, compared to the three months ended December 30, 2005.

	For the Three Months Ended		December 30, 2005	
	December 29, 2006		December 30, 2005	
Earnings before interest and taxes				
Government Services	\$ 34,361	10.2 %	\$ 20,654	5.5 %
Maintenance and Technical Support Services	272	0.2 %	3,635	2.0 %
Other(1)	(845)	NA	(714)	NA
Consolidated	\$ 33,788	6.5 %	\$ 23,575	4.3 %

(1) For the three months ended December 29, 2006, other consists of: (i) severance costs; (ii) joint venture income or loss; and (iii) compensation expense related to Class B equity participation not allocated to a specific segment. For the three months ended December 30, 2005, other primarily consists of joint venture income or loss and compensation expense related to Class B equity participation not allocated to a specific segment.

Government Services

Earnings before interest and taxes. Earnings before interest and taxes for the three months ended December 29, 2006 were \$34.4 million, an increase of \$13.7 million, or 66.2%, from \$20.7 million for the three months ended December 30, 2005. The GS increase was primarily driven by the following operating factors: (i) increased international police liaison officers in Iraq and Afghanistan; (ii) improved execution from fixed price contracts such as the Civilian Police and International Narcotics and Law Enforcement Air-Wing (Air-Wing) programs; and (iii) increased logistic support services under the Africa

Peacekeeping program with the Department of State. In addition, GS's earnings before interest and taxes during the quarter benefited \$4.4 million from a contract modification for construction efforts in Afghanistan completed in earlier periods. Partially offsetting the higher earnings before interest and taxes was lower profitability in our Worldwide Personal Protection Services programs due to completion of task orders in Israel, Haiti, Afghanistan and central Iraq and increased business development costs of \$2.4 million. Earnings before interest and taxes as a percentage of revenue for the three months ended December 29, 2006 and December 30, 2005 was 10.2% and 5.5%, respectively.

Maintenance and Technical Support Services

Earnings before interest and taxes. Earnings before interest and taxes for the three months ended December 29, 2006 were \$0.3 million, a decrease of \$3.3 million, or 91.7%, from \$3.6 million for the three months ended December 30, 2005. The MTSS decrease was primarily driven by: (i) operating losses from delivering services to the U.S. Army under the Life Cycle Contractor Support and the AH-1/UH-1 programs; and (ii) increased general and administrative costs of \$1.5 million. Partially offsetting the lower earnings before interest and taxes was improved profitability on our Contract Field Teams program. This program benefited from maintenance and repair activities performed on military equipment returning from Iraq and Afghanistan. Earnings before interest and taxes as a percentage of revenue for the three months ended December 29, 2006 and December 30, 2005 was 0.2% and 2.0%, respectively.

Nine Months Ended December 29, 2006 Compared To Nine Months Ended December 30, 2005

Consolidated

Revenues. Total revenues increased from \$1,418.2 million for the nine months ended December 30, 2005 to \$1,529.9 million for the nine months ended December 29, 2006, an increase of \$111.7 million or 7.9%. For the nine months ended December 29, 2006 and December 30, 2005, approximately 42%, 36% and 22% and approximately 27%, 38% and 35% of our revenues were derived from fixed-price, time-and-materials, and cost-reimbursement contracts, respectively.

Revenues from our GS segment increased from \$896.3 million for the nine months ended December 30, 2005 to \$1,001.9 million for the nine months ended December 29, 2006, an increase of \$105.6 million or 11.8%. The Air-Wing program increased \$65.4 million. The Department of State awarded our current contract under the Air-Wing program during May 2005. As part of the new contract, we successfully transitioned many of the activities under this program from cost-reimbursement to fixed-price. The factors contributing to higher revenues include increased eradication efforts in South America, combined with increased activity in Afghanistan providing aviation support to the ground eradication effort under the Civilian Police program. Our Civilian Police program contributed \$52.5 million to the increase in revenues. The Civilian Police program benefited from an increased number of international police liaison officers deployed in Iraq and Afghanistan, compared to the nine months ended December 30, 2005. In addition, while supporting the Iraq effort, we benefited from operations and maintenance support efforts, as well as additional procurement activities. The Logistics Support programs revenue increased by \$36.4 million, compared to the nine months ended December 30, 2005. The increase within the Logistics Support programs is primarily due to the added work under the Africa Peacekeeping contract with the Department of State. The factors contributing to increased revenues were partially offset by a reduction in services under the Worldwide Personal Protective Services program. We concluded four task orders under which we provided personal security services in Israel, Haiti, Afghanistan and central Iraq. The concluded task orders contributed a decrease in revenues for the nine months ended December 29, 2006 of \$68.2 million, compared to the nine months ended December 30, 2005.

Revenues from our MTSS segment increased from \$522.0 million for the nine months ended December 30, 2005 to \$528.0 million for the nine months ended December 29, 2006, an increase of

\$6.0 million or 1.1%. The MTSS increase was primarily driven by an increase in personnel and level of effort under the Contract Field Team program of \$19.1 million and increased domestic aviation services provided to the U.S. Air Force under the C-21 Contractor Logistics Support program and Andrews contract of \$19.6 million. Partially offsetting the higher revenue was the Army Prepositioned Stocks Afloat program, which decreased by \$17.7 million mainly due to the U.S. government reducing its funding. In addition, the Fort Hood contract under the Domestic Aviation program ended in July 2006, which resulted in a \$16.6 million decrease in revenues.

Costs of services. Costs 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 increased from \$1,262.1 million for the nine months ended December 30, 2005 to \$1,343.4 million for the nine months ended December 29, 2006, an increase of \$81.3 million or 6.4%. Despite recognizing operating costs in excess of contract funding to complete a base camp in Iraq in the second quarter of fiscal 2007 and the suspension of the ARAMCO security contract with a customer in Saudi Arabia, costs of services as a percentage of revenue decreased from 89.0% for the nine months ended December 30, 2005 to 87.8% for the nine months ended December 29, 2006. Factors that contributed to the decrease as a percent of revenue were: (i) continued strong performance of fixed-price task orders under the Civilian Police and Air-Wing programs; (ii) improved contract mix resulting from a larger proportion of higher-margin fixed-price and time-and-materials contracts; and (iii) a contract modification for construction efforts in Afghanistan completed in earlier periods.

Selling, general and administrative expenses. Selling, general and administrative expenses primarily relate to functions such as management, legal, financial accounting, contracts and administration, human resources, management information systems, purchasing and business development. Selling, general and administrative expenses for the nine months ended December 30, 2005 were \$60.0 million and increased to \$82.9 million for the nine months ended December 29, 2006, an increase of \$22.9 million or 38.2%. In addition, as a percentage of revenue, selling, general and administrative expenses increased from 4.2% for the nine months ended December 30, 2005 to 5.4% for the nine months ended December 29, 2006. Factors contributing to higher selling, general and administrative expenses for the nine months ended December 29, 2006 include: (i) an increase of \$9.5 million in business development costs; (ii) an increase of \$8.5 million in corporate administrative costs, primarily the result of developing these functions as an independent company; (iii) an increase of \$5.7 million in severance-related costs from the departure of senior executives; (v) an increase of \$1.6 million in legal costs; and (vi) \$0.8 million increase for bonuses paid to certain members of management related to the Equity Offering. Offsetting the increase in selling, general and administrative expenses was a benefit of \$4.7 million related to a reduction in bad debt expense.

Depreciation and amortization. Depreciation and amortization increased slightly from \$32.8 million for the nine months ended December 30, 2005 to \$33.0 million for the nine months ended December 29, 2006, an increase of \$0.2 million, or 0.6%.

Interest expense. Interest expense increased from \$42.3 million for the nine months ended December 30, 2005 to \$44.1 million for the nine months ended December 29, 2006. The interest expense incurred relates to our senior secured credit facility, revolving credit facility, senior subordinated notes and amortization of deferred financing fees. The increase is due to the higher interest expense related to the senior secured credit facility from increasing variable interest rates during the nine months ended December 29, 2006. Partially offsetting the higher variable rate interest expense was lower interest incurred on the senior subordinated notes, which have a fixed interest rate of 9.5%, due to the partial redemption in connection with the Equity Offering.

Interest on mandatory redeemable shares. Interest on the mandatory redeemable shares, or preferred stock, was \$14.1 million for the nine months ended December 29, 2006, compared to \$3.0 million for the

nine months ended December 30, 2005. All of our outstanding preferred stock was redeemed in connection with our Equity Offering in May 9, 2006, resulting in a shorter time outstanding, compared to the nine months ended December 30, 2005.

Loss on debt extinguishment and preferred stock. In conjunction with our Equity Offering in May 2006, we incurred: (i) a premium of \$5.7 million associated to the redemption of all of our outstanding preferred stock; (ii) a premium of \$2.7 million related to the redemption of a portion of our senior subordinated notes; and (iii) the write-off of \$0.8 million in deferred financing costs associated with the early retirement of a portion of our senior subordinated notes.

Income tax expense. We had income tax expense for the nine months ended December 29, 2006 of \$8.6 million, which is an increase of \$3.0 million from income tax expense of \$5.6 million for the nine months ended December 30, 2005. The increase is primarily the result of higher income before tax. We had an effective tax rate of 51.6% for the nine months ended December 29, 2006. In connection with our Equity Offering, we redeemed, at a premium, all of our mandatory redeemable shares outstanding. This premium is considered a discreet item for tax purposes and is not deductible. In addition, we incurred interest expense on our mandatory redeemable shares that is not deductible. Our effective tax rate before consideration of the discreet item and the interest on mandatory redeemable shares was 36.3%.

Results by Segment

We evaluate segment performance based primarily on the non-GAAP measure of EBIT, which includes the effects of corporate expense allocations. EBIT is a non-GAAP measure that includes operating income, other income and income (loss) from joint ventures. Items that we do not include in EBIT are interest expense and income taxes, each of which we evaluate on a consolidated level. We believe EBIT is a useful measurement of our performance because it provides information that can be used to evaluate the effectiveness of our businesses from an operational perspective, exclusive of the costs to finance those activities and exclusive of income taxes, neither of which is directly relevant to the efficiency of those operations.

EBIT should not be considered an alternative to, or a more meaningful indicator of our operating performance than, operating income or net income as determined in accordance with GAAP. In addition, our EBIT may not be comparable to a similarly titled measure of another company.

The following table (dollars in thousands) sets forth earnings before interest and taxes for our GS and MTSS operating segments, both in dollars and as a percentage of segment specific revenue, for the nine months ended December 29, 2006, compared to the nine months ended December 30, 2005.

	For the Nine Months Ended			
	December 29, 2006		December 30, 2005	
Earnings before interest and taxes				
Government Services	\$ 72,537	7.2 %	\$ 47,033	5.2 %
Maintenance and Technical Support Services	7,444	1.4 %	17,156	3.3 %
Other(1)	(6,978)	NA	(670)	NA
Consolidated	\$ 73,003	4.8 %	\$ 63,519	4.5 %

(1) For the nine months ended December 29, 2006, other consists of: (i) severance costs; (ii) joint venture income or loss; and (iii) compensation expense related to Class B equity participation not allocated to a specific segment. For the nine months ended December 30, 2005, other primarily consists of joint venture income or loss and management retention bonuses and compensation expense related to Class B equity participation not allocated to a specific segment.

Government Services

Earnings before interest and taxes. Earnings before interest and taxes for the nine months ended December 29, 2006 were \$72.5 million, an increase of \$25.5 million, or 54.3%, from \$47.0 million for the nine months ended December 30, 2005. The GS increase was primarily driven by the following operating factors: (i) improved profitability on fixed-price task orders under the Civilian Police and Air-Wing programs due to strong performance and favorable contract changes; and (ii) increased logistic support services under the Africa Peacekeeping program with the Department of State. In addition, GS's earnings before interest and taxes for the current year benefited \$4.4 million from a contract modification for construction efforts in Afghanistan completed in earlier periods. Partially offsetting the higher earnings before interest and taxes were: (i) costs in excess of contract funding to complete the construction of a base camp in Iraq for the Department of State; (ii) charges related to the suspension of a security contract with a customer located in Saudi Arabia; (iii) lower profitability in our Worldwide Personal Protection Services programs due to completion of task orders in Israel, Haiti, Afghanistan and central Iraq; and (iv) increased general and administrative costs of \$6.8 million to support the growth of GS segment, corporate administrative and business development costs, net of \$4.3 million related to a reduction in bad debt expense. Earnings before interest and taxes as a percentage of revenue for the nine months ended December 29, 2006 and December 30, 2005 was 7.2% and 5.2%, respectively.

Maintenance and Technical Support Services

Earnings before interest and taxes. Earnings before interest and taxes for the nine months ended December 29, 2006 were \$7.4 million, a decrease of \$9.8 million, or 57.0%, from \$17.2 million for the nine months ended December 30, 2005. The decrease was primarily driven by: (i) operating losses from delivering services to the U.S. Army under the Life Cycle Contractor Support and AH-1/UH-1 programs; and (ii) increased general and administrative costs of \$10.7 million resulting from corporate administrative and business development functions. Partially offsetting the lower earnings before interest and taxes was improved profitability on our Contract Field Teams program. This program benefited from maintenance and repair activities performed on military equipment returning from Iraq and Afghanistan. Earnings before interest and taxes as a percentage of revenue for the nine months ended December 29, 2006 and December 30, 2005 was 1.4% and 3.3%, respectively.

Liquidity and Capital Resources

The following table sets forth cash flow data for the periods indicated therein (dollars in thousands):

	For the Nine Months Ended	
	December 29, 2006	December 30, 2005
Net cash provided by operating activities	\$ 45,788	\$ 54,162
Net cash used in investing activities	(5,374)	(3,538)
Net cash used in financing activities	(5,651)	(39,295)

Cash Flows

Operating Activities. Cash and cash equivalents as of December 29, 2006 were \$55.3 million compared to \$24.8 million as of December 30, 2005. Net cash provided by operating activities for the nine months ended December 29, 2006 was \$45.8 million, while net cash provided by operating activities for the nine months ended December 30, 2005 was \$54.2 million. The nine months ended December 29, 2006 experienced unfavorable timing of cash collections, which resulted in a use of cash of \$3.8 million. In addition, during the nine months ended December 29, 2006, operating cash flow benefited from accounts payable and accrued liability activities related to the timing of payroll processing, timing of interest payments and customer advances. The timing for payroll processing, interest payments and customer

advances can vary from quarter to quarter. Other factors impacting operating cash flow during the nine months ended December 29, 2006 included: (i) one-time cash payments of \$6.7 million for interest related to the Company's preferred stock; and (ii) payment of special cash bonuses subsequent to our Equity Offering of \$3.125 million in the aggregate to our executive officers and certain other members of management. These bonuses rewarded management for their efforts in connection with the successful consummation of our Equity Offering. Operating cash flow for the nine months ended December 30, 2005 reflected high cash collections, which resulted in a \$30.9 million source of cash. Partially offsetting the increased collection activity was significant vendor payments.

Investing Activities. Net cash used in investing activities was \$5.4 million and \$3.5 million for the nine months ended December 29, 2006 and December 30, 2005, respectively. For the nine months ended December 29, 2006 and December 30, 2005, the primary use of cash was to purchase property and equipment.

Financing Activities. Net cash used in financing activities was \$5.7 million and \$39.3 million for the nine months ended December 29, 2006 and December 30, 2005, respectively. The cash used during the nine months ended December 29, 2006 included: (i) gross proceeds received from the Equity Offering of \$375.0 million; (ii) payment of Equity Offering costs of \$30.0 million; (iii) partial redemption of senior subordinated notes of \$28.8 million, including accrued interest; (iv) redemption of all outstanding preferred stock and related accrued and unpaid interest of \$228.5 million; and (v) payment of special Class B distribution of \$100.0 million. The cash used in financing activities during the nine months ended December 30, 2005 was due to the \$35.0 million repayment of borrowings under our revolving credit facility, the \$2.6 million scheduled repayment of our bank note borrowings, the \$1.2 million payment of offering expenses and the \$0.5 million purchase of an interest rate cap that limits our exposure to upward movements in variable rate debt.

Based on our current level of operations, we believe our cash flow from operations and our available borrowings under our senior secured credit facility will be adequate to meet our liquidity needs for at least the next twelve months. However, servicing our indebtedness will require a significant amount of cash. Our ability to generate sufficient cash depends on numerous factors beyond our control and we cannot be assured that our business will generate sufficient cash flow from operations, or that future borrowings will be available to us under our senior secured credit facility in an amount sufficient to enable us to repay our indebtedness, including the senior subordinated notes, or to fund our other liquidity needs.

Equity Offering

On May 9, 2006, we consummated an Equity Offering of 25,000,000 shares of our Class A common stock, par value \$0.01 per share, at a price of \$15.00 per share. The gross proceeds from the Equity Offering of \$375.0 million, together with cash on hand, were used: (i) to redeem all of our outstanding preferred stock, of which \$222.8 million in stated amount, including accrued and unpaid dividends thereon, was outstanding as of May 9, 2006; (ii) to pay a special Class B distribution in the amount of \$100.0 million, representing a return of capital of \$95.9 million to DIV Holding LLC, the holder of our common stock; (iii) to redeem \$28.0 million of our senior subordinated notes on June 8, 2006; (iv) to pay prepayment penalties of \$8.4 million, \$5.7 million of which represented prepayment penalties on our preferred stock and \$2.7 million of which represented prepayment penalties on our senior subordinated notes; and (v) to pay transaction expenses of approximately \$35.0 million, including an underwriters' commission of \$22.5 million, a fee of \$5.0 million to Veritas Capital and \$7.5 million of miscellaneous fees and expenses related to the Equity Offering.

Debt and Other Obligations

Our senior secured credit facility contains financial covenants, including a minimum interest coverage ratio and a maximum total debt to EBITDA ratio, and places certain restrictions on our ability to make capital expenditures. These financial ratios include a minimum interest coverage ratio and a leverage ratio. The interest coverage ratio is the ratio of EBITDA (as defined in our senior revolving credit facility) to cash interest expense for trailing quarters. The minimum interest coverage ratio increases from 2:1 to 3.2:1.0 during the term of the senior secured credit facility. The required interest coverage ratio for the third quarter of fiscal 2007 is 2.2 to 1.0. The maximum leverage coverage ratio decreases from 6:1 to 3:1 during the term of the senior secured credit facility. The required leverage coverage ratio for the third quarter of fiscal 2007 is 5.25 to 1.0. At December 29, 2006, we had an interest coverage ratio and leverage coverage ratio of 2.98:1.00 and 3.88:1.00, respectively. The senior secured credit facility also restricts the maximum amount of our capital expenditures during each year of the senior secured credit facility. Capital expenditures are expenditures that are required by GAAP to be included in the purchase of property and equipment. Our senior secured credit facility is secured by substantially all of our assets and the assets of our domestic subsidiaries, by a pledge of all of the capital stock of our domestic subsidiaries and by 65% of the capital stock of our first tier foreign subsidiaries. The initial borrowings thereunder are subject to customary closing conditions.

On January 9, 2006, we entered into a first amendment and waiver of our senior secured credit facility. The first amendment and waiver increased the revolving commitment under our senior secured credit facility by \$15.0 million to \$90.0 million, which includes an increase in the sub-limit for letters of credit equal to the same amount. The first amendment and waiver also permitted us to: (i) pay a transaction fee to Veritas Capital related to our Equity Offering of up to \$10.0 million; (ii) pay a distribution to the holders of our Class B common stock in an amount equal to the sum of (x) \$100.0 million plus (y) the proceeds, if any, of the underwriters' over-allotment option, net of discount and estimated offering expenses; (iii) redeem all of our then currently outstanding preferred stock; and (iv) redeem up to \$65.0 million of the \$320.0 million aggregate principal amount of the senior subordinated notes. The first amendment and waiver waived the requirement in the senior secured credit facility that we use 50% of the net cash proceeds from our Equity Offering to prepay loans under the senior secured credit facility and/or permanently reduce the revolving commitments.

On June 28, 2006, the Company, through its operating company, DynCorp International LLC, entered into a second amendment and waiver of our senior secured credit facility, dated February 11, 2005. The second amendment and waiver provided for a senior secured credit facility of \$431.6 million, representing a \$90.0 million revolver and a \$341.6 million outstanding term loan. The maturity date of the amended senior secured credit facility remains unchanged. The second amendment and waiver also provided for the following, among other things: (i) decreased the interest rate applicable to the term loan under our senior secured credit facility; (ii) permits us to request an increase in our revolving credit facility by an aggregate amount of up to \$30.0 million, subject to the Company obtaining commitments from existing and/or new lenders; (iii) increases the amount of capital expenditures permitted under our senior secured credit facility from \$4.0 million per fiscal year to \$8.0 million per fiscal year; (iv) increases the amount of capitalized leases permitted under our senior secured credit facility from \$10.0 million per fiscal year to \$25.0 million per fiscal year; (v) allows for the payment of dividends and the repurchase of our capital stock in the amount of \$10.0 million plus, if our leverage ratio (as defined in our senior secured credit facility) is below 3.25:1.00, 25% of our excess cash flow (as defined in our senior secured credit facility) for each fiscal year; and (vi) provides for the first excess cash flow payment, as defined by the senior secured credit facility, to commence on our fiscal year that ends on March 30, 2007.

In November 2006, the Company obtained additional commitments from two new lenders which increased the revolving credit facility to \$103,000. On December 29, 2006, the Company had \$93,899

available under the senior secured credit facility. This amount gives effect to \$9,101 in outstanding letters of credit as of December 29, 2006.

As of December 29, 2006, we had \$631.9 million of indebtedness, including the senior subordinated notes and excluding interest accrued thereon, of which \$339.8 million was secured.

Other Long-Term Liabilities

Other long-term liabilities includes \$2.5 million of tenant improvement concessions pertaining to the Company's lease of one of its facilities. The lease will be amortized over the life of the lease as prescribed by SFAS No. 13, *Accounting for Leases*, and FASB Technical Bulletin 88-1, *Issues Relating to Accounting for Leases*. In addition, other long-term liabilities include \$3.2 million for future expected payments to employees required by a foreign jurisdiction in the event of unilateral termination.

Off-Balance Sheet Arrangements

As of December 29, 2006, other than the operating leases discussed in note 11 to the condensed consolidated financial statements, we had no off-balance sheet arrangements.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which are prepared in accordance with GAAP. The preparation of these financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingencies at the date of the financial statements as well as the reported amounts of revenues and expenses during the reporting period. Management evaluates these estimates and assumptions on an ongoing basis, including those relating to revenue recognition and cost estimation on long-term contracts, allowance for doubtful accounts, determination of goodwill and customer-related intangible assets, goodwill impairment, accounting for contingencies and litigation and accounting for income taxes. Our estimates and assumptions have been prepared on the basis of the most current available information. The results of these estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could materially differ from these estimates under different assumptions and conditions.

We have several critical accounting policies that are important to the portrayal of our financial condition and results of operations and that require management's most difficult, subjective and complex judgments. Typically, the circumstances that make these judgments complex and difficult have to do with making estimates about the effect of matters that are inherently uncertain. Our critical accounting estimates are as noted below.

Revenue Recognition and Cost Estimation on Long-Term Contracts

We provide our services under fixed-price, time-and-materials, and cost-reimbursement contracts. The form of contract, rather than the type of service offering, is the primary determinant of revenue recognition. Revenues are recognized when persuasive evidence of an arrangement exists, services or products have been provided to the client, the sales price is fixed or determinable and collectibility is reasonably assured.

Revenue on fixed-price contracts is generally recognized ratably over the contract period, measured by either output or input methods appropriate to the services or products provided. For example, output measures can include period of service, such as for aircraft fleet maintenance, and units delivered or

produced, such as aircraft for which modification has been completed. Input measures can include a cost-to-cost method, such as for procurement-related services.

Revenue on fixed-price construction or production-type contracts, when they occur, is recognized on the basis of the estimated percentage of completion. Progress towards completion is typically measured based on achievement of specified contract milestones, when available, or based on costs incurred as a proportion of estimated total costs. Profit in a given period is reported at the expected profit margin to be achieved on the overall contract. This method can result in the deferral of costs or profit on these contracts. Management regularly reviews project profitability and underlying estimates. Revisions to the estimates at completion are reflected in results of operations as a change in accounting estimate in the period in which the facts that give rise to the revision become known by management. Revenue on fixed-price contracts that have a duration of less than six months is recognized on the completed contract method. Work in progress is classified as a component of inventory.

We provide for anticipated losses on contracts by a charge to income during the period in which the losses are first identified. Amounts billed but not yet recognized as revenue under certain types of contracts are deferred. Unbilled receivables are stated at estimated realizable value. Contract costs on U.S. government contracts, including indirect costs, are subject to audit and adjustment by negotiations between us and government representatives. Substantially all of our indirect contract costs have been agreed upon through 2004. Contract revenues on U.S. government contracts have been recorded in amounts that are expected to be realized upon final settlement.

Contract costs are expensed as incurred, except as described above and on certain other production-type fixed-price contracts, where costs are deferred until such time that associated revenue is recognized.

Client contracts may include the provision of more than one of our services. For revenue arrangements with multiple deliverables, revenue recognition includes the proper identification of separate units of accounting and the allocation of revenue across all elements based on relative fair values.

Many of our contracts are time-and-materials or fixed hourly/daily rate contracts. For these contracts, revenue is recognized each month based on actual hours/days charged to the program during that month multiplied by the fixed hourly/daily rate in the contract for the type of labor charged. Any material or other direct charges are recognized as revenue based on the actual direct cost plus Defense Contract Management Agency-approved indirect rates.

Cost-reimbursement type contracts can be either cost plus fixed fee, or cost plus award fee. Revenue recognition for these two contract types is very similar. In both cases, revenue is based on actual direct cost plus Defense Contract Management Agency-approved indirect rates. In the case of cost plus fixed fee, the fixed fee is recognized based on the ratio of the fixed fee for the contract to the total estimated cost of the contract. In the case of cost plus award fee contracts, the fee is made up of two components, base fee and award fee. Base fee is recognized in the same manner as the fee on cost plus fixed fee contracts. The award fee portion is recognized based on an average of the last two award fee periods or award experience for similar contracts for new contracts that lack specific experience.

Allowance for Doubtful Accounts

We establish allowance for doubtful accounts against specific billed receivables based upon the latest information available to determine whether invoices are ultimately collectible. Such information includes the historical trends of write-offs and recovery of previously written-off accounts, the financial strength of the respective customer and projected economic and market conditions. The evaluation of these factors involves subjective judgments, and changes in these factors may cause a misstatement of our accounts receivable, which could significantly impact our consolidated financial statements by incurring bad debt

expense. Given that we primarily serve the U.S. government, we believe the risk to be relatively low that a misstatement of accounts receivable would have a material impact on our financial results.

Determination of Goodwill and Customer-Related Intangible Assets

In accordance with SFAS No. 141, *Business Combinations*, the 2005 Acquisition was accounted for using the purchase method of accounting. This method requires estimates to determine the fair values of assets and liabilities acquired, including judgments to determine any acquired intangible assets such as customer-related intangibles, internally developed technology and tradename, as well as assessments of the fair value of tangible assets such as property and equipment. Liabilities acquired include reserves for litigation and other contingency reserves established prior to, or at the time of, acquisition and require judgment in ascertaining a reasonable value as well.

Third-party valuation firms assisted management in the appraisal of certain assets and liabilities, but even those determinations were based on significant estimates provided by us. For example, the value ultimately assigned to customer-related intangibles and internally developed technology were determined by a third-party valuation firm as of the date of acquisition, based on estimates and judgments provided by us regarding expectations for the estimated future after-tax cash flows from those assets over their lives, including the probability of expected future contract renewals and sales, less a cost-of-capital charge, all of which was discounted to present value. If actual future after-tax cash flows are significantly lower than our estimates, we may be required to record an impairment charge to write down the identifiable intangible assets to their realizable values.

The value assigned to the 2005 Acquisition goodwill equaled the amount of the purchase price in excess of the sum of the amounts assigned to the identifiable acquired assets, both tangible and intangible, less liabilities assumed. At December 29, 2006, we had goodwill of \$420.2 million and identifiable intangible assets of \$242.7 million.

Goodwill and Intangible Impairment

We review goodwill and intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. We also review goodwill annually, during our fourth quarter, in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*. SFAS No. 142 requires that goodwill be tested, at a minimum, annually for each reporting unit using a two-step process. A reporting unit is an operating segment, as defined in paragraph 10 of SFAS No. 131, *Disclosures About Segments of an Enterprise and Related Information*, or a component of an operating segment. The goodwill impairment test is a two-step process that requires management to make judgments in determining what assumptions to use in the calculation. Management judgments include, but are not limited to, estimates for future sales, operating income, depreciation and amortization, income tax payments, working capital changes and capital expenditures, as well as expected growth rates for cash flows and long-term interest rates. The first step of the process consists of estimating the fair value of each of the reporting units based on a discounted cash flow model and comparing those estimated fair values with the carrying values, which includes the allocated goodwill. If a potential impairment is identified, the second step is to measure the impairment loss by comparing the implied fair value of goodwill with the carrying value of goodwill of the reporting unit. The implied fair value of goodwill is the residual fair value derived by deducting the fair value of a reporting unit's identifiable assets and liabilities from its estimated fair value calculated in step one. The impairment charge, if any, would represent the excess of the carrying amount of the reporting unit's goodwill over the implied fair value of its goodwill. A decline in estimated fair value of a reporting unit could result in an impairment charge to goodwill, which could have a material adverse effect on our business, financial condition and results of operations. We completed our impairment analysis of goodwill as of February 24, 2006, noting no indications of impairment for any of our reporting units. During the nine months ended December 29, 2006, we recognized an impairment of

approximately \$0.6 million associated with a customer-related intangible for a loss of a contract in Saudi Arabia.

Accounting for Contingencies and Litigation

We are subject to various claims and contingencies associated with lawsuits, insurance, tax and other issues arising out of the normal course of business. The consolidated financial statements reflect the treatment of claims and contingencies based on our view of the expected outcome. We consult with legal counsel on issues related to litigation and seek input from other experts and advisors with respect to matters in the ordinary course of business. If the likelihood of an adverse outcome is probable and the amount is estimable, we accrue a liability in accordance with SFAS No. 5, *Accounting for Contingencies*. Significant changes in the estimates or assumptions used in assessing the likelihood of an adverse outcome could have a material effect on our consolidated financial results.

Accounting for Income Taxes

Realization of our deferred tax assets is primarily dependent on future U.S. taxable income. SFAS No. 109, *Accounting for Income Taxes*, provides for the recognition of deferred tax assets if realization of such assets is more likely than not. As a result of recent U.S. operating results together with the Company's forecasts of future pretax operating results, we believe that net deferred tax assets in the amount of \$20.4 million are realizable based on the more likely than not standard required for recognition.

We are a U.S.-based multinational company subject to tax in multiple U.S. and foreign tax jurisdictions. The Company's provision for income taxes is based on a jurisdictional mix of earnings, statutory rates and enacted tax rules. Significant judgment is required in determining the Company's provision for income taxes and in evaluating its tax positions on a worldwide basis. The Company believes its tax position is consistent with the tax laws in the jurisdictions in which it conducts its business. It is possible that these positions may be challenged, which may have a significant impact on the Company's effective tax rate.

Recent Accounting Pronouncements

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108 (SAB 108), *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*, to address diversity in practice in quantifying financial statement misstatements. SAB No. 108 requires that we quantify misstatements based on their impact on each of our financial statements and related disclosures. SAB No. 108 is effective as of the end of fiscal 2007, allowing a one-time transitional cumulative effect adjustment to retained earnings as of April 1, 2006 for errors that were not previously deemed material, but are material under the guidance in SAB No. 108. We are currently evaluating the impact SAB No. 108 will have on our consolidated financial statements.

In September 2006, the Financial Accounting Standards Board (the FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. This statement does not require any new fair value measurements; rather, it applies under other accounting pronouncements that require or permit fair value measurements. The provisions of this statement are to be applied prospectively as of the beginning of the fiscal year in which this statement is initially applied, with any transition adjustment recognized as a cumulative-effect adjustment to the opening balance of retained earnings. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We are currently evaluating the impact of adopting SFAS No. 157 on our consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting and reporting for income taxes recognized in accordance with SFAS No. 109, *Accounting for Income Taxes*. This interpretation prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. The requirements of FIN 48 are effective for fiscal periods beginning after December 15, 2006. We are currently evaluating the impact of FIN 48 on our consolidated financial statements.

On May 18, 2006, the State of Texas passed a bill replacing the current franchise tax with a new margin tax that will go into effect on January 1, 2008. We estimate that the new margin tax will not have a significant impact on tax expense or deferred tax assets and liabilities.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections - a replacement of APB Opinion No. 20 and FASB Statement No. 3*. SFAS No. 154 provides guidance on the accounting for, and reporting of, accounting changes and error corrections. It establishes, unless impracticable, retrospective application as the required method for reporting a change in accounting principle in the absence of explicit transition requirements specific to the newly adopted accounting principle. SFAS No. 154 also provides guidance for determining whether retrospective application of a change in accounting principle is impracticable and for reporting such a change when retrospective application is impracticable. The provisions of SFAS No. 154 are effective for accounting changes and corrections of errors made in fiscal periods beginning after December 15, 2005. The adoption of SFAS No. 154 did not have any effect on our consolidated financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in market risk from the information provided in Part II, Item 7A, *Quantitative and Qualitative Disclosures About Market Risk* in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2006, filed with the SEC on June 29, 2006.

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(e) and 15d-15(e) 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.

(b) *Changes in Internal Controls*

There have been no changes in our internal controls over financial reporting that have occurred during our fiscal quarter ended December 29, 2006 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On December 4, 2006, a lawsuit was served, and amended on December 29, 2006, on behalf of 1,663 citizens of the Ecuadorian provinces of Esmeraldas and Sucumbios, 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. The action 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, as a consequence of the spraying of narcotic plant crops along the Colombian border adjacent to Ecuador. The spraying operations are the same operations which are the subject of the litigation discussed in note 11 to the condensed consolidated financial statements and are conducted under a Department of State contract in cooperation with the Colombian government. The terms of the Department of State contract provide that the Department of State will indemnify DynCorp International LLC against third-party liabilities arising out of the contract, subject to available funding.

On December 29, 2006, a lawsuit was served on behalf of the Providence of Sucumbios in Ecuador, 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. The action alleges violations of Ecuadorian law, international law, and the statutes and common law of Florida, including negligence, trespass, and nuisance, as a consequence of the spraying of narcotic plant crops along the Colombian border adjacent to Ecuador. The spraying operations are the same operations which are the subject of the litigation described in the immediately preceding paragraph. The relevant Department of State contract provides indemnification to DynCorp International LLC against third-party liabilities arising out of the contract, subject to available funding.

On January 30, 2007, the Special Inspector General for Iraq Reconstruction (SIGIR) issued a report on Company contract number S-LMAQM-04-C-0030, Task Order 0338, concerning the Iraqi Police Training Program. Among other items, the report raises questions about the Company's work under Task Order 0338 to establish a residential camp in Baghdad to house training personnel. Specifically, the SIGIR report recommends that the Director, Office of Acquisition Management, U.S. Department of State (State Department), seek reimbursement from the Company of \$4.2 million paid by the State Department for work that the SIGIR maintains was not contractually authorized. In addition, the SIGIR report recommends that the State Department request the Defense Contract Audit Agency to review two Company invoices totaling \$19.1 million. In management's opinion and based on facts currently known, the above described matters raised in the SIGIR report will not have a material adverse effect on the Company's consolidated financial condition, results of operations or liquidity.

There have been no other material changes in legal proceedings from those provided in Part I, Item 3, Legal Proceedings in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2006, filed the SEC on June 29, 2006.

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 31, 2006, filed with the SEC on June 29, 2006.

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

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

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

Exhibit Number	Description	
3.1	Amendment No. 5 to the Amended and Restated Limited Liability Company Operating Agreement of DIV Holding LLC	(A)
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.

(A) Previously filed as an exhibit to DynCorp International Inc. s Form 8-K, filed with the SEC on December 15, 2006 and incorporated herein by reference.

SIGNATURES

Pursuant to the requirements of 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 12, 2007

/s/ MICHAEL J. THORNE

Name:

Title:

Michael J. Thorne

Senior Vice President, Chief Financial Officer
and Treasurer (principal financial officer and
Duly Authorized Officer)