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ECC INTERNATIONAL CORP  
Form 10-K  
October 15, 2001

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549  
FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended June 30, 2001

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 001-8988

ECC INTERNATIONAL CORP.  
(Exact name of registrant as specified in its charter)

|  |   |
|--|---|
| Delaware   | 23-1714658                              |
| -----  |   |
| (State of other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification Number) |
| 2001 West Oak Ridge Road, Orlando, Florida                     | 32809-3803                              |
| -----  |   |
| (Address of principal executive offices)                       | (Zip Code)                              |

Registrant's telephone number, including area code (407) 859-7410

Securities registered pursuant to Section 12(b) of the Act:

|   |   |
|---|---|
| Title of each class<br>Common Stock, \$.10 par value<br>----- | Name of each exchange on which registered<br>American Stock Exchange<br>----- |
|---|---|

Securities registered pursuant to Section 12(g) of the Act:  
None

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(Title of class)

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. [X] YES [ ] NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

As of September 17, 2001, the aggregate market value of the Registrant's Common Stock held by non-affiliates of the Registrant was \$16,586,570. (This figure was computed on the basis of the closing price for the Registrant's Common Stock on September 17, 2001, using the number of shares held by stockholders who are not officers, directors or record holders of 10% or more of the Registrant's outstanding Common Stock. The characterization of such officers, directors and 10% stockholders as affiliates is for purposes of the computation only and should not be construed as an admission for any purpose whatsoever that any of such persons are, in fact, affiliates of the Registrant.)

As of September 17, 2001, there were 7,830,285 shares of the Registrant's Common Stock, \$0.10 par value per share, outstanding.

Information with respect to directors in Item 10 and the information required by Items 11-13 is incorporated by reference to the definitive proxy statement of the Registrant to be filed with the Commission in connection with its Annual Meeting of Stockholders scheduled for November 30, 2001.

The Exhibit Index is located on pages 38 through 41.

PART I

ITEM 1 BUSINESS

(A) GENERAL DEVELOPMENT OF BUSINESS

- (1) ECC International Corp, a Delaware corporation organized in 1969 (the "Company" or "ECC"), designs, manufactures and markets computer controlled simulators used primarily for training personnel to perform maintenance and operator procedures on military weapons systems. The Company's simulators measure performance as a trainee operates the equipment, conducts equipment tests, diagnoses programmed malfunctions and takes corrective actions. The Company's equipment is used by all four branches of the U.S. Department of Defense as well as numerous foreign governments for familiarization, operator training and maintenance training for aircraft, missiles, tanks, combat vehicles and small arms weapons. The Company's systems also have application in industrial and vocational training programs, such as control room simulators for power plants and law enforcement training.

The Company also offers training and educational products to purchasers of its simulators and to others. These products consist of the development of training programs and curricula, development of

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multimedia programs and computer based training, preparation of training handbooks and instruction on the use of the Company's simulators.

The Company designs and manufactures substantially all of the components of its simulator systems, with the exception of certain equipment such as commercially available computers, CRTs, disk drives and printers, which it purchases. The Company is not dependent on any one supplier for raw materials or computer related equipment used in or sold as part of its systems. The Company's systems are marketed through a direct sales force and independent international sales representatives.

The Company was not in compliance with certain financial covenants during fiscal year 2001. The Company is in the process of resolving the non-compliance issues by negotiating amended covenants and a reduced Credit Facility limit. Negotiations are expected to be completed by November 1, 2001. Based on the Company's positive cash balance since July 13, 2001, and the positive cash projections for the balance of fiscal year 2002, it appears that operational cash requirements can be funded internally and minimal borrowings are required.

During fiscal year 1999, the Company completed the wind-down of its U.K. operation, ECC Simulation Limited (the "U.K. operation"). See Note 15 in the Notes to the Consolidated Financial Statements.

During fiscal year 1998, the Company completed the sale of the fixed assets, inventory and trade receivables of the Company's vending operation. The sale of the vending operation was accounted for as a discontinued operation and accordingly, the vending operations were segregated in the accompanying Selected Financial Data.

(2) Not applicable

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### (B) FINANCIAL INFORMATION ABOUT INDUSTRY SEGMENTS

The Company operates only in the training segment. This segment includes the design and manufacture of training simulators and the development of training programs and curricula. See Note 12 in the Notes to the Consolidated Financial Statements.

### (C) NARRATIVE DESCRIPTION OF BUSINESS

- |     |       |   |
|-----|-------|---|
| (1) | (i)   | Principal Products, Services and Revenue Sources  |
|     |       | See the information set forth above in Item 1(a) and (b).   |
|     | (ii)  | New Products  |
|     |       | Not applicable.   |
|     | (iii) | Raw Materials   |
|     |       | The components used in training systems, as well as the parts used to manufacture the computers and |

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devices used in the Company's systems are purchased from original equipment manufacturers, electronics supply firms and others. The Company has no reason to believe that it cannot continue to obtain such components, or suitable substitutes, as it may require.

- (iv) Patents, Trademarks, Licenses, Franchises and Concessions

Not applicable.

- (v) Seasonality of Business

The Company's business is not seasonal in nature.

- (vi) Working Capital Practices

The Company's working capital practices are similar to other government contractors.

- (vii) Dependence on Customer

The Company's training business is government related and channeled to the Company principally through the United States Department of Defense. For the fiscal year ended June 30, 2001, 41% of sales were made directly to the U.S. Department of Defense, while 59% of sales were made to various other contractors for ultimate use by the U.S. Department of Defense. Within the U.S. Department of Defense, there are various agencies that are "customers" of the Company, with the largest being the U.S. Navy and the U.S. Army. The largest prime contractors that are customers of the Company are Lockheed Martin Corporation and Raytheon/Lockheed Martin JAVELIN Joint Venture. See Note 12 in the Notes to the Consolidated Financial Statements.

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- (viii) Backlog

At June 30, 2001, the Company's backlog (which represents that portion of outstanding contracts not yet included in revenue) was approximately \$103 million of which \$85 million represented contract options. At June 30, 2000, the Company's backlog was \$86 million of which \$64 million represented contract options. It is anticipated that approximately 85% of the backlog, exclusive of contract options, at June 30, 2001 will be delivered during the fiscal year ending June 30, 2002.

- (ix) Renegotiation or Termination of Contracts or Subcontracts at Government's Election

The Company's government contracts contain standard

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terms permitting termination without cause at the option of the government. In the event of termination of such contracts, the Company is entitled to receive reimbursement on the basis of work completed (cost incurred plus a reasonable profit).

(x) Competitive Conditions

The Company competes with a large number of firms. Many of the Company's competitors are substantially larger and have greater financial resources. Competition is based upon both price and performance considerations. Positive factors pertaining to the Company's competitive position are that the Company has a large base of installed systems and substantially more experience than its competitors in the computer controlled maintenance simulation field. The Company believes that this defense segment continues to have growth potential and expects to see new competitors in this market.

(xi) Independent Research and Development (IR&D)

During the fiscal years ended June 30, 2001, 2000, and 1999, approximately \$957,000, \$376,000 and \$803,000, respectively, was spent on Company sponsored research activities, including manufacturing, engineering and software development relating to the development of new products and product enhancements. During both fiscal years 2001 and 2000, the Company did not have any customer sponsored research activities. During the fiscal year ended June 30, 2001, the Company employed the equivalent of four (4) full-time professional employees whose prime responsibility was in research and development activities. In addition, from time to time the Company utilizes the specialized skills of many of its other employees and contract personnel on a limited engagement basis.

(xii) Environment

Not Applicable.

(xiii) Number of Persons Employed

As of June 30, 2001, the Company employed approximately 200 persons.

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(D) FINANCIAL INFORMATION ABOUT FOREIGN AND DOMESTIC OPERATIONS AND EXPORT SALES

Export sales were immaterial to the Company's gross sales. See Note 12 in the Notes to the Consolidated Financial Statements.

ITEM 2 PROPERTIES

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The Company owns its simulation development and manufacturing facilities, which are situated on 25 acres in Orlando, Florida. The main plant facility totals 398,086 square feet. Ancillary buildings on the property total 69,847 square feet. The Company subleases the 72,500 square foot facility previously used by the former vending operation in Orlando, Florida. The Company considers the capacity of its facilities to exceed its present needs and is in the process of attempting to sell the facilities to a third party with a long term leaseback of approximately 150,000 square feet. To date, the Company has no agreements, commitments or understandings with respect to the sale of the facility.

### ITEM 3 LEGAL PROCEEDINGS

Currently, the Company is not a party to any material pending legal proceedings.

### ITEM 4 SUBMISSIONS OF MATTERS TO A VOTE OF SECURITY HOLDERS

There was no vote of security holders during the fourth quarter of the fiscal year.

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### EXECUTIVE OFFICERS AND KEY MANAGEMENT EMPLOYEES OF THE REGISTRANT

Each of the following officers and key management employees of the Company was elected by the Board of Directors and serves at the discretion of the Board.

| NAME<br>----               | AGE<br>--- | POSITION WITH THE REGISTRANT<br>-----              |
|----------------------------|------------|--|
| Dr. James C. Garrett       | 56         | President, Chief Executive Officer and Director    |
| Glenn C. Andrew            | 53         | Executive Vice President                           |
| Melissa A. Van Valkenburgh | 48         | Vice President, Finance<br>Chief Financial Officer |
| Stephen R. Stankiewicz     | 52         | Vice President, Business Development               |

Dr. Garrett assumed his position in June 1998; Mr. Andrew assumed his position in October 1998; Ms. Van Valkenburgh assumed her position in March 1999; and Mr. Stankiewicz assumed his position in May 2000.

DR. GARRETT has had an extensive career in the defense and aerospace industries spanning over 29 years. Prior to joining ECC, he served as Vice President and General Manager of the Raytheon E-Systems Communications Division, a position to which he was named in 1991, with responsibility for a broad range of projects. During the course of a twenty-year career with Rockwell International Corporation, Dr. Garrett served as Vice President of the Command and Control Systems, Satellite and Secure Systems, Tactical Products and Engineering Divisions.

MR. ANDREW was with Rockwell International for 25 years, most recently as Vice President and General Manager of the Communications Systems Division in Dallas,

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Texas. In 1996, he was charged with putting a recovery plan in place for Rockwell's combat systems for Australia. Mr. Andrew also served as director of Rockwell's satellite communications business area and held various engineering positions, including Director of Engineering.

MS. VAN VALKENBURGH is a Certified Public Accountant who most recently was Controller of Applied Materials Incorporated at their Austin, Texas site. She previously served for 17 years at Rockwell International where she was Controller of several of its Defense Electronic Divisions. Prior to that, she worked in public accounting with Deloitte & Touche for 5 years.

MR. STANKIEWICZ most recently served as Director of Marketing for AAI Corporation. He previously served as Director of Government Programs at Evans & Sutherland Computer Corporation. He also served as a naval flight officer in the U.S. Navy Reserve.

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### PART II

#### ITEM 5 MARKET FOR THE REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

##### (A) MARKET INFORMATION

The Common Stock of the Company is currently listed on the American Stock Exchange (symbol ECC). Prior to November 6, 2000, the Company was listed on the New York Stock Exchange. The price range of the Common Stock during the last two fiscal years was as follows:

| QUARTER ENDED<br>----- | HIGH<br>---- | LOW<br>--- |
|------------------------|--------------|------------|
| June 30, 2001          | \$ 3.66      | \$ 3.25    |
| March 31, 2001         | 3.88         | 3.41       |
| December 31, 2000      | 4.00         | 3.13       |
| September 30, 2000     | 4.00         | 2.81       |
| June 30, 2000          | 3.75         | 3.00       |
| March 31, 2000         | 4.00         | 3.06       |
| December 31, 1999      | 3.81         | 3.06       |
| September 30, 1999     | 4.19         | 3.06       |

Common Stock prices shown above are the last daily sales prices on the American or New York Stock Exchange. During the fiscal year ended June 30, 2001, the Company repurchased 727,000 shares of Common Stock through open-market purchases.

##### (B) HOLDERS

As of September 15, 2001, the Company had approximately 863 stockholders of record of its Common Stock based on the transfer agent's listings. The Company believes its shares are beneficially held by several thousand additional stockholders based on broker dealer demand for proxy materials in 2000.

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### (C) DIVIDENDS

No cash dividends have been declared on the Company's common stock during the last six years. Under the Company's Credit Facility, the Company is not permitted to pay cash dividends. See Note 7 in the Notes to the Consolidated Financial Statements.

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### ITEM 6 SELECTED FINANCIAL DATA (In Thousands, Except Per Share Data)

|   | Years Ended June 30, |          |           |           |
|---|----------------------|----------|-----------|-----------|
|   | 2001                 | 2000     | 1999      | 1998      |
| <b>Operating Data:</b>                                      |                      |          |           |           |
| <b>Continuing Operations:</b>                               |                      |          |           |           |
| Net Sales   | \$ 28,736            | \$40,876 | \$ 48,676 | \$ 52,618 |
| Operating Income/(Loss)                                     | (6,876)              | 3,985    | (3,874)   | (13,775)  |
| Net Income/(Loss)   | (7,139)              | 3,389    | (3,546)   | (12,409)  |
| <b>Discontinued Operations:</b>                             |                      |          |           |           |
| Net Sales   | --                   | --       | --        | --        |
| Operating Income/(Loss)                                     | --                   | --       | --        | --        |
| Net Income/(Loss)   | --                   | --       | --        | (407)     |
| <b>Per Share Data Basic:</b>                                |                      |          |           |           |
| Weighted Average Number of<br>Common Shares Outstanding     | 8,025                | 8,436    | 8,346     | 8,174     |
| Earnings/(Loss) Per Common Share<br>Continuing Operations   | \$ (0.89)            | \$ 0.40  | \$ (0.42) | \$ (1.52) |
| Earnings/(Loss) Per Common Share<br>Discontinued Operations | --                   | --       | --        | (0.05)    |
| Earnings/(Loss) Per Common Share                            | \$ (0.89)            | \$ 0.40  | \$ (0.42) | \$ (1.57) |
| Cash Dividends Per Common Share                             | \$ --                | \$ --    | \$ --     | \$ --     |
| <b>Per Share Data-Assuming Dilution:</b>                    |                      |          |           |           |
| Weighted Average Number of<br>Common Shares Outstanding     | 8,025                | 8,485    | 8,346     | 8,174     |
| Earnings/(Loss) Per Common Share<br>Continuing Operations   | \$ (0.89)            | \$ 0.40  | \$ (0.42) | \$ (1.52) |
| Earnings/(Loss) Per Common<br>Share Discontinued Operations | --                   | --       | --        | (0.05)    |
| Earnings/(Loss) Per Common Share                            | \$ (0.89)            | \$ 0.40  | \$ (0.42) | \$ (1.57) |



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As of June 30

| Balance Sheet Data:  | 2001     | 2000     | 1999     | 1998     | 1997    |
|----------------------|----------|----------|----------|----------|---------|
| -----                | -----    | -----    | -----    | -----    | -----   |
| Total Assets         | \$27,772 | \$39,235 | \$48,713 | \$64,358 | \$82,03 |
| Working Capital      | \$10,391 | \$17,921 | \$13,063 | \$11,385 | \$35,35 |
| Long-Term Debt       | \$ --    | \$ --    | \$ --    | \$ --    | \$16,64 |
| Stockholders' Equity | \$23,772 | \$33,689 | \$30,087 | \$33,437 | \$45,54 |

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As a result of the Company's sale of its vending operation during fiscal year 1998, the vending operation was accounted for as a discontinued operation beginning in fiscal year 1997. Accordingly, the vending operation was segregated in the Consolidated Statements of Operations.

ITEM 7 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended. For this purpose, any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, the words "believes," "anticipates," "plans," "expects," and similar expressions are intended to identify forward-looking statements. There are a number of factors that could cause the Company's actual results to differ materially from those indicated by such forward-looking statements. These factors include, without limitation, those set forth below under the caption "Certain Factors That May Affect Future Operating Results."

(A) (1) AND (2) LIQUIDITY AND CAPITAL RESOURCES

During both fiscal years 2000 and 2001, the Company's principal source of cash was from operations. The principal use of these funds was to pay down the revolving Credit Facility and fund additions to property, plant and equipment. In addition, during fiscal year 2001, funds were used to purchase Treasury Stock.

Cash provided by operating activities was \$627,000 in fiscal year 2001 compared to \$8.2 million for fiscal year 2000 and \$1.3 million for fiscal year 1999. Fiscal year 2001 operating cash flow reflects the Company's net loss of \$7.1 million.

Cash used for investing activities was \$381,000 in fiscal year 2001 compared to \$893,000 in fiscal year 2000 and \$61,000 in fiscal year 1999. The decrease from fiscal year 2000 is due primarily to lower investments in property, plant and equipment.

The Company's financing activities used \$2.6 million of cash in fiscal year 2001 compared to \$6.4 million in fiscal year 2000 and \$4.6 million in fiscal year 1999. Borrowings and repayments under the Credit Facility were approximately equal in fiscal year 2001; however \$2.9 million was utilized to repurchase treasury stock.

On December 10, 1998, the U.K. operation entered into a Novation Agreement with

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Lockheed. Under the agreement, the U.K. operation assigned all rights and obligations under a certain contract to Lockheed. The terms of the novation permitted the U.K. operation to extend payments already owing to Lockheed to monthly installments through December 2000. At June 30, 2000, the total outstanding amount due to Lockheed was approximately \$1.2 million, which was included in Accrued Expenses and Other of the Consolidated Financial Statements. This balance was paid in full during fiscal year 2001.

On June 24, 1999, the Company entered into a new revolving credit facility ("Credit Facility") with Mellon Bank, N. A., which was subsequently purchased by LaSalle Business Credit, totaling \$12.5 million and expiring on June 24, 2003. Proceeds from the Credit Facility were used to pay the outstanding balance under the Company's loan facility with its previous primary lender. There was an outstanding balance under the Credit Facility at June 30, 2001 of \$157,000.

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The Company was not in compliance with certain financial covenants during fiscal year 2001. The Company is in the process of resolving the non-compliance issues by negotiating amended covenants and a reduced Credit Facility limit. Negotiations are expected to be completed by November 1, 2001. Based on the Company's positive cash balance since July 13, 2001, and the positive cash projections for the balance of fiscal year 2002, management believes that operational cash requirements can be funded internally.

The Company anticipates spending approximately \$500,000 for new machinery and equipment and to continue to refurbish the Orlando, Florida facility during fiscal year 2002.

During fiscal year 1999, the Company implemented various cost reduction initiatives and changes in management including the relocation of the corporate headquarters from Wayne, Pennsylvania to the Company's principal location in Orlando, Florida. In addition, as a result of recurring net losses in the U.K. operation (\$2.7 million and \$7.9 million in fiscal years 1999 and 1998, respectively), the Board of Directors announced, during the first quarter of fiscal year 1999, the approval of a plan to wind-down and discontinue the U.K. operation. The wind-down was completed in May 1999. These initiatives resulted in a charge of approximately \$3.5 million during fiscal year 1999. See Note 15 in the Notes to the Consolidated Financial Statements.

During fiscal year 2001, the Company reduced its operating costs by eliminating approximately 45 employees or 15% of the total number of employees during the first quarter and 60 employees or 24% of the total number of employees during the second quarter. Termination benefits associated with the reductions were approximately \$517,000 in the first quarter and approximately \$901,000 in the second quarter. Annual compensation savings associated with these actions in the first and second quarters were \$1,500,000 and \$2,800,000, respectively. All employee termination benefits were paid by June 30, 2001, with the exception of \$105,000, which is included in Accrued Expenses and Other.

Management's plans to improve future profitability include: (1) a continuation of both direct and indirect cost reduction initiatives and improvement of operating performance, (2) an aggressive focus on obtaining follow-on awards to existing business, and (3) the implementation of strategies to procure new business and penetrate new markets.

Other than as stated above, the Company has no other material commitments for capital expenditures. Management believes that with the funds available under its projected cash flow, the Company will have sufficient resources to meet planned operating commitments for the foreseeable future.

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In keeping in line with current corporate governance practices and the goal to increase shareholder value, on August 9, 2000, the Board of Directors terminated the Shareholders Rights Agreement dated August 27, 1996. All stockholders of record at the close of business on August 9, 2000, received \$0.01 for each Right held. The Board also approved a stock repurchase plan to invest up to \$3.0 million for the repurchase of the Company's common stock. Approval to execute this plan was obtained from Mellon Bank, N.A. under the Company's Credit Facility. A total of 727,000 shares were repurchased in fiscal year 2001 for \$2.9 million.

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### 3) RESULTS OF OPERATIONS

#### 2001 COMPARED WITH 2000

Net sales decreased \$12.1 million (30%) in fiscal year 2001 compared to fiscal year 2000. This decrease is primarily due to the completion of the Javelin Multi-Year 1, F-18, UK CATT and AGTS contracts and delays in the awards of the Javelin Multi-Year 2 and EST Lot 2 contracts.

Gross margin as a percentage of sales decreased to 14% in fiscal year 2001 compared to 33% in fiscal year 2000. The lower margins are primarily a result of the completion of several high margin contracts in fiscal year 2000 and the spreading of fixed costs over a smaller revenue base. In addition, the Company incurred \$1.4 million of severance costs in fiscal year 2001 and recorded additional losses totaling \$1.3 million related to completion of the EST system development due to continuing technical issues.

Selling, general and administrative expense increased \$791,000 (9%) in fiscal year 2001 compared to fiscal year 2000. This increase is primarily a result of increased bid and proposal, and marketing investments related to the pursuit of new business and increased bad debt expense related to recording a reserve for doubtful accounts for receivables associated with the former U.K. operation totaling \$657,000. See Note 2 in the Notes to the Consolidated Financial Statements. These increases were partially offset by decreases in SG&A salaries and bonuses.

Independent research and development (IR&D) expense increased \$581,000 (155%) in fiscal year 2001 compared to fiscal year 2000 primarily due to research in the area of new simulation technologies and products.

Interest expense decreased \$383,000 (53%) in fiscal year 2001 compared to fiscal year 2000. This decrease is primarily a result of improved cash flows from operations that enabled the Company to maintain a positive cash balance for the first five months of fiscal year 2001.

Deferred tax assets increased \$2.7 million (60%) in fiscal year 2001 compared to fiscal year 2000 due primarily to increased Federal Operating Loss Carryforwards. The tax valuation allowance was increased by the same amount due to the uncertainty as to the ultimate realization of these assets.

#### 2000 COMPARED WITH 1999

Net Sales decreased \$7.8 million (16%) for fiscal year 2000 compared to fiscal year 1999. This decrease is primarily due to reduced activity in the U.K. resulting from the wind-down of its operations in fiscal year 1999. See Notes 12 and 15 in the Notes to the Consolidated Financial Statements.

Gross margin as a percentage of net sales increased to 33% in fiscal year 2000

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compared to 25% in fiscal year 1999. This increase is primarily the result of increased gross margin levels in several contracts including Javelin, F-18 and UK CATT. In addition, the Company's cost reduction initiatives during fiscal year 2000 reduced overhead costs, thus improving gross margins.

Selling, general and administrative expense decreased \$2.6 million (22%) in fiscal year 2000 compared to fiscal year 1999. The decrease is primarily the result of continued cost containment initiatives during fiscal year 2000 as well as the completion of the U.K. operations wind-down during fiscal year 1999. See Note 15 in the Notes to the Consolidated Financial Statements.

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Additionally, the Company's legal and bad debt expenses were significantly lower in fiscal year 2000 due to the settlement of the Company's Economic Price Adjustment claim in the fourth quarter of fiscal year 1999. See Note 2 in the Notes to the Consolidated Financial Statements.

IR&D expense decreased \$427,000 (53%) in fiscal year 2000 compared to fiscal year 1999. This decrease was primarily a result of more focused initiatives and cost containment efforts.

Unusual expenses decreased to zero compared to fiscal year 1999 as a result of recognizing approximately \$3.5 million in expenses during fiscal year 1999 relating to the U.K. operation wind-down and relocation of the Company headquarters. See Note 15 in the Notes to the Consolidated Financial Statements.

Interest expense decreased \$325,000 (31%) compared to fiscal year 1999 as a result of improved cash flows from operations.

### CERTAIN FACTORS THAT MAY AFFECT FUTURE OPERATING RESULTS

The following important factors, among others, could cause actual results to differ materially from those indicated by forward-looking statements made in this Annual Report on Form 10-K and presented elsewhere by management from time to time. All forward-looking statements included in this Form 10-K are based on information available to the Company on the date hereof, and the Company assumes no obligation to update such forward-looking statements.

A number of uncertainties exist that could affect the Company's future operating results including, without limitation, general economic conditions, changes in government spending, borrowing availability under and compliance with the Credit Facility, amending the covenants to the Credit Facility, cancellation of weapons programs, delays in contract awards, delays in the acceptance process of contract deliverables, the Company's continued ability to develop and introduce products, the introduction of new products by competitors, pricing practices of competitors, the cost and availability of parts and the Company's ability to control costs.

To date, a substantial portion of the Company's revenues have been attributable to long-term contracts with various government agencies. As a result, any factor adversely affecting procurement of long-term government contracts could have a material adverse effect on the Company's financial condition and results of operations.

Because of these and other factors, past financial performance should not be considered an indication of future performance. The Company's future quarterly operating results may vary significantly. Investors should not use historical trends to anticipate future results and should be aware that the trading price of the Company's Common Stock may be subject to wide fluctuations in response to

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quarterly variations in operating results and other factors, including those discussed above.

### ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company has a variable rate revolving credit facility and, as such, has exposure to interest rate fluctuations. Under current market conditions, the impact of an increase or decrease in the prevailing interest rates would not materially effect the Company's consolidated financial position or results of operations. As of June 30, 2001, the outstanding balance under the revolving credit facility was \$157,000.

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### ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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### REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Shareholders and  
the Board of Directors of  
ECC International Corp.

In our opinion, the financial statements listed in the accompanying index present fairly, in all material respects, the financial position of ECC International Corp. and its Subsidiaries (the "Company") at June 30, 2001 and 2000, and the results of their operations and their cash flows for each of the

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three years in the period ended June 30, 2001 in conformity with accounting principles generally accepted in the United States. In addition, in our opinion, the financial statement schedule listed in the accompanying index, presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

/s/ PRICEWATERHOUSECOOPERS LLP

PricewaterhouseCoopers LLP  
Orlando, Florida  
September 11, 2001

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ECC INTERNATIONAL CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
For the Years Ended June 30, 2001, 2000 and 1999  
(In Thousands, Except Per Share Data)

|                                      | 2001      | 2000      |
|--------------------------------------|-----------|-----------|
|                                      | -----     | -----     |
| Net Sales                            | \$ 28,736 | \$ 40,876 |
| Cost of Sales                        | 24,735    | 27,386    |
|                                      | -----     | -----     |
| Gross Profit                         | 4,001     | 13,490    |
|                                      | -----     | -----     |
| Expense:                             |           |           |
| Selling, General & Administrative    | 9,920     | 9,129     |
| Independent Research and Development | 957       | 376       |
| Unusual Expenses                     | --        | --        |
|                                      | -----     | -----     |
| Total Expense                        | 10,877    | 9,505     |
|                                      | -----     | -----     |
| Operating Income/(Loss)              | (6,876)   | 3,985     |
|                                      | -----     | -----     |
| Other Income/(Expense):              |           |           |
| Interest Income                      | 62        | 151       |
| Interest Expense                     | (344)     | (727)     |
| Other-Net                            | 179       | (20)      |
|                                      | -----     | -----     |
| Total Other Expense                  | (103)     | (596)     |
|                                      | -----     | -----     |
| Income/(Loss) Before Income Taxes    | (6,979)   | 3,389     |
| Provision/(Benefit) for Income Taxes | 160       | --        |

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|   |            |          |
|---|------------|----------|
| Net Income/(Loss)   | \$ (7,139) | \$ 3,389 |
| Net Income/(Loss) Per Common Share-Basic and Assuming Dilution: | \$ (0.89)  | \$ 0.40  |

See accompanying notes to consolidated financial statements.

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ECC INTERNATIONAL CORP. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
As of June 30, 2001 and 2000  
(In Thousands, Except Share and Per Share Data)

|   | 2001      | 2000      |
|---|-----------|-----------|
|   | -----     | -----     |
| <b>ASSETS</b>   |           |           |
| Current:  |           |           |
| Cash  | \$ 39     | \$ 2,406  |
| Accounts Receivable   | 4,521     | 7,359     |
| Cost and Estimated Earnings in Excess of<br>Billings on Uncompleted Contracts   | 8,283     | 10,455    |
| Inventories   | 1,154     | 2,559     |
| Prepaid Expenses and Other  | 307       | 449       |
|   | -----     | -----     |
| Total Current Assets  | 14,304    | 23,228    |
|   | -----     | -----     |
| Property, Plant and Equipment, Net  | 13,352    | 15,476    |
| Other Assets  | 116       | 531       |
|   | -----     | -----     |
| Total Assets  | \$ 27,772 | \$ 39,235 |
|   | =====     | =====     |
| <b>LIABILITIES</b>  |           |           |
| Current:  |           |           |
| Current Portion of Long-Term Debt   | \$ 157    | \$ --     |
| Accounts Payable  | 1,829     | 1,438     |
| Accrued Expenses and Other  | 1,927     | 3,869     |
|   | -----     | -----     |
| Total Current Liabilities   | 3,913     | 5,307     |
|   | -----     | -----     |
| Deferred Income Taxes   | 61        | 80        |
| Other Long-Term Liabilities   | 26        | 159       |
|   | -----     | -----     |
| Total Liabilities   | 4,000     | 5,546     |
|   | -----     | -----     |
| <b>COMMITMENTS AND CONTINGENCIES</b>  |           |           |
| <b>STOCKHOLDERS' EQUITY:</b>  |           |           |
| Preferred Stock, \$0.10 par; 1,000,000 shares authorized;<br>None issued and outstanding  | --        | --        |
| Common Stock, \$0.10 par; 20,000,000 shares authorized;<br>8,557,285 shares issued and 7,830,285 outstanding in 2001 and<br>8,481,067 shares issued and outstanding in 2000 | 856       | 848       |
| Note Receivable from Stockholder  | (168)     | (146)     |

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|  |           |           |
|--|-----------|-----------|
| Capital in Excess of Par                   | 25,441    | 25,211    |
| Retained Earnings                          | 552       | 7,776     |
| Treasury Stock 727,000 shares              | (2,909)   | --        |
|  | -----     | -----     |
| Total Stockholders' Equity                 | 23,772    | 33,689    |
|  | -----     | -----     |
| Total Liabilities and Stockholders' Equity | \$ 27,772 | \$ 39,235 |
|  | =====     | =====     |

See accompanying notes to consolidated financial statements.

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ECC INTERNATIONAL CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
For the Years Ended June 30, 2001, 2000 and 1999  
(In Thousands, Except Share Data)

|   | Common<br>Stock | Treasury<br>Stock | Capital<br>In Excess<br>of Par | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income/(Loss) |
|---|-----------------|-------------------|--------------------------------|----------------------|--|
|   | -----           | -----             | -----                          | -----                | -----  |
| Balance as of June 30, 1998                   | \$832           | \$ --             | \$ 24,804                      | \$ 7,933             | \$ 14  |
| Net Loss                                      | --              | --                | --                             | (3,546)              | --   |
| Stock Issued:                                 |                 |                   |                                |                      |  |
| Employee Stock Purchase<br>Plan-59,349 Shares | 6               | --                | 115                            | --                   | --   |
| Exercise of Options-<br>2,000 Shares          | --              | --                | 4                              | --                   | --   |
| Issuance of Common Stock<br>32,558 Shares     | 3               | --                | 82                             | --                   | --   |
| Translation Adjustment                        | --              | --                | --                             | --                   | (14)   |
| Balance as of June 30, 1999                   | 841             | --                | 25,005                         | 4,387                | --   |
| Net Income                                    | --              | --                | --                             | 3,389                | --   |
| Stock Issued:                                 |                 |                   |                                |                      |  |
| Employee Stock Purchase<br>Plan-38,291 Shares | 4               | --                | 112                            | --                   | --   |
| Exercise of Options -<br>3,400 Shares         | --              | --                | 7                              | --                   | --   |
| Issuance of Common Stock-<br>27,211 Shares    | 3               | --                | 87                             | --                   | --   |
| Balance as of June 30, 2000                   | 848             | --                | 25,211                         | 7,776                | --   |
| Net Loss                                      | --              | --                | --                             | (7,139)              | --   |
| Stock Issued:                                 |                 |                   |                                |                      |  |
| Employee Stock Purchase<br>Plan-17,529 Shares | 2               | --                | 49                             | --                   | --   |
| Exercise of Options -                         |                 |                   |                                |                      |  |



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|                                |       |            |          |        |       |
|--------------------------------|-------|------------|----------|--------|-------|
| 54,337 Shares                  | 6     | --         | 166      | --     | --    |
| Issuance of Common Stock-      |       |            |          |        |       |
| 4,354 Shares                   | --    | --         | 15       | --     | --    |
| Renegotiation of Note          |       |            |          |        |       |
| Recvd from Stockholder         | --    | --         | --       | --     | --    |
| Purchase of Stockholder Rights | --    | --         | --       | (85)   | --    |
| Treasury Stock                 |       |            |          |        |       |
| 727,000 shares                 | --    | (2,909)    | --       | --     | --    |
|                                | ----  | -----      | -----    | -----  | ----- |
| Balance as of June 30, 2001    | \$856 | \$ (2,909) | \$25,441 | \$ 552 | \$ -- |
|                                | ===== | =====      | =====    | =====  | ===== |

Common shares outstanding at June 30, 1999, 2000 and 2001 were 8,412,165, 8,481,067 and 7,830,285 shares, respectively.

See accompanying notes to consolidated financial statements

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ECC INTERNATIONAL CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
For the Years Ended June 30, 2001, 2000 and 1999  
(In Thousands)

|   | 2001       | 2000     | 1999    |
|---|------------|----------|---------|
|   | -----      | -----    | -----   |
| Cash Flows From Operating Activities:                   |            |          |         |
| Net Income/(Loss)                                       | \$ (7,139) | \$ 3,389 | \$ (3,5 |
| Adjustments to Reconcile Net Income to Net Cash         |            |          |         |
| Provided by/(Used For) Operating Activities:            |            |          |         |
| Depreciation  | 2,645      | 3,919    | 4,2     |
| Amortization  | 101        | 421      |         |
| Loss/(Gain) on Sale of Assets                           | (140)      | 25       | (2      |
| Deferred Income Taxes                                   | --         | --       | (1,4    |
| Changes in Certain Assets and Liabilities:              |            |          |         |
| Accounts Receivable                                     | 2,816      | (2,621)  | 3,3     |
| Cost and Estimated Earnings in Excess of                |            |          |         |
| Billings on Uncompleted Contracts                       | 2,172      | 8,039    | (2,1    |
| Inventories   | 1,405      | 1,752    | 8       |
| Prepaid Expenses and Other                              | 436        | (329)    | 4,8     |
| Accounts Payable  | 258        | (1,479)  | (2      |
| Advances on Long-Term Contracts                         | --         | --       | (3,2    |
| Accrued Expenses and Other                              | (1,927)    | (4,914)  | (1,2    |
|   | -----      | -----    | -----   |
| Net Cash Provided By Operating Activities               | 627        | 8,202    | 1,2     |
|   | -----      | -----    | -----   |
| Cash Flows From Investing Activities:                   |            |          |         |
| Proceeds From Sale of Assets                            | 154        | 18       | 5       |
| Additions to Property, Plant and Equipment              | (535)      | (911)    | (1,9    |
| Other, Primarily Cash Surrender Value of Life Insurance | --         | --       | 1,3     |
|   | -----      | -----    | -----   |
| Net Cash Used In Investing Activities                   | \$ (381)   | \$ (893) | \$ (    |
|   | -----      | -----    | -----   |

ECC INTERNATIONAL CORP. AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF CASH FLOWS  
 For the Years Ended June 30, 2001, 2000 and 1999  
 (In Thousands)

|   | 2001<br>----- | 2000<br>----- | 1999<br>----- |
|---|---------------|---------------|---------------|
| Cash Flows From Financing Activities:                           |               |               |               |
| Proceeds From Issuance of Common Stock and<br>Options Exercised | \$ 223        | \$ 123        | \$ 125        |
| Purchase of Treasury Stock                                      | (2,909)       | --            | --            |
| Purchase of Stockholder Rights                                  | (85)          | --            | --            |
| Debt Issue Costs for Revolving Credit Facility                  | --            | (87)          | --            |
| Net Repayments Under Revolving Credit Facility                  | (18,800)      | (6,424)       | (4,708)       |
| Net Borrowings Under Revolving Credit Facility                  | 18,957        | --            | --            |
|   | -----         | -----         | -----         |
| Net Cash Used In Financing Activities                           | (2,614)       | (6,388)       | (4,583)       |
|   | -----         | -----         | -----         |
| Net Increase/(Decrease) in Cash                                 | (2,367)       | 921           | (3,345)       |
| Cash at Beginning of the Year                                   | 2,406         | 1,485         | 4,830         |
|   | -----         | -----         | -----         |
| Cash at End of the Year   | \$ 39         | \$ 2,406      | \$ 1485       |
|   | =====         | =====         | =====         |
| Supplemental Disclosures of Cash Flow Information:              |               |               |               |
| Cash Paid During the Year for:                                  |               |               |               |
| Interest  | \$ 329        | \$ 720        | \$ 1,086      |
| Supplemental Schedule of Non Cash Financing Activities:         |               |               |               |
| Issuance of Director Equity Compensation                        | \$ 15         | \$ 90         | \$ 85         |
| Purchase of Fixed Assets Through Capital Leases                 | \$ --         | \$ 254        | \$ --         |
| Extended Payment Terms in Connection with<br>Novation Agreement | \$ --         | \$ --         | \$ 4,552      |

See accompanying notes to consolidated financial statements

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SIGNIFICANT ACCOUNTING POLICIES

CONSOLIDATION

The consolidated financial statements include the accounts of ECC International Corp. and its wholly owned subsidiaries (collectively, the "Company"). Intercompany transactions have been eliminated in consolidation.

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### REVENUE AND COST RECOGNITION

Contract sales and anticipated profits are recognized using the percentage of completion method, measured by the ratio of costs incurred to date to estimated total costs. Since many contracts extend over a long period of time, any revisions in estimated costs or contract value during the progress of work have the effect of adjusting the current period earnings applicable to performance in prior periods.

Contract costs include all direct labor and material costs and an allocation of indirect costs, such as indirect labor, supplies and depreciation.

Anticipated losses on contracts in progress are recorded in the period in which the losses are identified. Claims are included as a component of contract value for purposes of revenue recognition at such time as the amount is reasonably determinable and probable.

Unbilled costs and estimated earnings consists principally of contract revenue related to long term contracts which has been recognized for accounting purposes but is not yet billable to the customer. Substantially all of these amounts will be billed in the following fiscal year.

### USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

### INVENTORIES

Work in process inventory is valued using the specific identification cost method, but not in excess of net realizable value. Raw materials are valued at the lower of average cost or market.

### CASH AND CASH EQUIVALENTS

Cash equivalents are comprised of highly liquid financial instruments with maturities of three months or less when purchased.

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### PROPERTY, PLANT AND EQUIPMENT

Property, Plant and Equipment is stated at cost. Depreciation is provided on the straight-line method over the estimated useful lives of the respective assets and ranges from 10 to 30 years for buildings and building improvements, 3 to 10 years for machinery and equipment, and 5 years for demonstration and test equipment.

The cost of maintenance and repairs is charged to expense as incurred. Renewals and betterments are capitalized. Applicable asset and accumulated depreciation accounts are reduced for a sale or other disposition and the resulting gain or loss is included in the Consolidated Statements of Operations.

### IMPAIRMENT OF LONG LIVED ASSETS

Long lived assets are reviewed for impairment when events or circumstances

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indicate that the carrying amount of the asset may not be recoverable. The estimated future undiscounted cash flows associated with the asset are compared to the asset's carrying value to determine if a write-down is required. If impairment is indicated, the carrying amount of the asset is reduced to its fair value.

### INCOME TAXES

The Company utilizes the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized by applying enacted statutory tax rates to temporary differences between the tax basis and financial statement carrying value of the Company's assets and liabilities. A valuation allowance is provided where it is more likely than not that deferred tax assets will not be realized.

### RESEARCH AND DEVELOPMENT COSTS

Company sponsored research and development costs are included as part of the general and administrative costs. These activities include manufacturing, engineering and software research and development relating to the development of new products and product enhancements. Customer sponsored research and development costs incurred pursuant to contracts are accounted for as contract costs. There were no customer sponsored research and development costs for fiscal years 1999, 2000 and 2001.

### TREASURY STOCK

Repurchased shares of the Company's common stock are included in treasury stock at cost.

### STOCK-BASED COMPENSATION

The Company measures compensation expense for employee and director stock options as the aggregate difference between the market and exercise prices of the options on the date that both the number of shares the grantee is entitled to receive and the purchase price are known. Pro-forma information relating to the fair value of stock-based compensation is presented in Note 11 to the Consolidated Financial Statements.

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### EARNINGS/(LOSS) PER SHARE

Basic earnings/(loss) per common share is computed by dividing net income/(loss) available to common shareholders by the weighted-average number of common shares outstanding during the period. Diluted earnings/(loss) per share is computed by dividing net income/(loss) available to common shareholders by the weighted-average number of common shares outstanding during the period adjusted for the number of shares that would have been outstanding if dilutive potential common shares resulting from the exercise of stock options had been issued. The diluted earnings/(loss) per share does not assume the exercise of stock options that would have an antidilutive effect on earnings/(loss) per share.

The Company's dilutive potential common shares consists of stock options. In calculating diluted earnings per share, approximately 49,000 dilutive potential common shares were included in fiscal year 2000. The number of potentially dilutive common shares in 2001 and 1999 was 60,000 and 53,000, however they were not included in computing earnings per share since they would have had an antidilutive effect. The number of shares used in computing earnings per share is as follows:

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|          | Years Ended June 30, |           |           |
|----------|----------------------|-----------|-----------|
|          | 2001                 | 2000      | 1999      |
|          | -----                | -----     | -----     |
| Basic    | 8,025,000            | 8,436,000 | 8,346,000 |
| Dilutive | 8,025,000            | 8,485,000 | 8,346,000 |

PRESENTATION

Certain amounts in fiscal year 1999 have been reclassified to conform to the fiscal year 2000 Financial Statement presentation.

NEW ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141, Business Combinations (SFAS 141) and Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (SFAS 142). SFAS 141 addresses financial accounting and reporting for business combinations and requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Under SFAS 142, goodwill and certain other intangible assets will no longer be systematically amortized but instead will be reviewed for impairment and written down and charged to results of operations when their recorded value exceeds their estimated fair value. SFAS 142 is effective for fiscal years beginning after December 15, 2001, with early adoption permitted for entities with fiscal years beginning after March 15, 2001. The Company expects to adopt SFAS 142 effective July 1, 2001. The Company does not expect a significant impact on future financial results as a result of adopting this standard.

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NOTE 2 ACCOUNTS RECEIVABLE

|                                      | (In Thousands) |          |
|--------------------------------------|----------------|----------|
|                                      | 2001           | 2000     |
|                                      | -----          | -----    |
| Contract Receivables, Billed Amounts | \$ 4,200       | \$ 7,077 |
| Other                                | 321            | 282      |
|                                      | -----          | -----    |
| Total                                | \$ 4,521       | \$ 7,359 |
|                                      | =====          | =====    |

Contract receivables include amounts under long-term contracts and subcontracts principally with the U.S. Government or its contractors.

During fiscal year 1996, the Company submitted a claim for contract adjustment under the Economic Price Adjustment ("EPA") provisions of a major contract seeking approximately \$950,000. The value of the claim was included as a component of contract value for purposes of revenue recognition and accordingly was included in costs and estimated earnings in excess of billings on completed contracts at June 30, 1998. During the fourth quarter of fiscal year 1999, a

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settlement was agreed to on all claims in the form of a \$15,000 sum payable to the Company. This settlement resulted in a \$935,000 charge to earnings during the fourth quarter of fiscal year 1999.

During the fourth quarter of fiscal year 2001, upon advice of legal counsel, the Company recorded a reserve for doubtful accounts for \$657,000 against the collection of receivables related to the former U.K. operation. The U.K. operation wind down was completed in May 1999 and there have been no collections against these receivables. There was no reserve for doubtful accounts in fiscal year 2000.

### NOTE 3 INVENTORIES

|                               | (In Thousands) |          |
|-------------------------------|----------------|----------|
|                               | 2001           | 2000     |
|                               | -----          | -----    |
| Work in Process               | \$ 97          | \$ 88    |
| Raw Materials                 | 3,869          | 4,635    |
| Reserve for Excess & Obsolete | (2,812)        | (2,164)  |
|                               | -----          | -----    |
| Total                         | \$ 1,154       | \$ 2,559 |
|                               | =====          | =====    |

Work in Process Inventory is valued using the specific identification cost method, but not in excess of net realizable value. Raw materials are valued at the lower of average cost or market. The reserve for excess and obsolete inventory is based on an analysis of the specific parts, which includes an assessment of their potential use on future programs. During the fourth quarter of fiscal year 2001, the Company commenced a reconfiguration process of its plant, which will require the disposition of low value excess raw material inventory. As a result, the reserve was increased by \$1,041,000.

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### NOTE 4 PROPERTY, PLANT AND EQUIPMENT

|                                  | (In Thousands) |           |
|----------------------------------|----------------|-----------|
|                                  | 2001           | 2000      |
|                                  | -----          | -----     |
| Land                             | \$ 2,216       | \$ 2,216  |
| Buildings/Improvements           | 20,957         | 20,883    |
| Machinery and Equipment          | 19,361         | 20,106    |
| Demonstration and Test Equipment | 8,914          | 8,914     |
|                                  | -----          | -----     |
| Total                            | 51,448         | 52,119    |
| Less Accumulated Depreciation    | (38,096)       | (36,643)  |
|                                  | -----          | -----     |
| Total                            | \$ 13,352      | \$ 15,476 |
|                                  | =====          | =====     |

The Company considers its facilities to be excessive for its present needs and

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is in the process of attempting to sell the facilities to a third party and implement a long term leaseback of approximately 150,000 square feet.

Repairs and maintenance expense for the fiscal years ended June 30, 2001, 2000 and 1999 were \$713,000, \$1,093,000 and \$582,000, respectively.

### NOTE 5 ACCRUED EXPENSES AND OTHER

|                           | (In Thousands) |         |
|---------------------------|----------------|---------|
|                           | 2001           | 2000    |
|                           | -----          | -----   |
| Compensation              | \$ 278         | \$ 321  |
| Vacation                  | 436            | 844     |
| Incentive Plans           | --             | 561     |
| Contract Losses           | 281            | 162     |
| Lockheed Novation Payable | --             | 1,199   |
| Other                     | 932            | 782     |
|                           | -----          | -----   |
| Total                     | \$1,927        | \$3,869 |
|                           | =====          | =====   |

On December 10, 1998, the U.K. operation entered into a Novation Agreement with Lockheed Martin ASIC (Lockheed). Under the agreement, the U.K. operation assigned all rights and obligations under a certain contract to Lockheed. The terms of the novation permitted the U.K. operation to extend payments, already owing to Lockheed, to monthly installments through December 2000. The total outstanding due to Lockheed was approximately \$1.2 million as of June 30, 2000. The final installment was paid in January 2001.

### NOTE 6 EMPLOYEE BENEFIT PLANS

The Company has a 401K plan that was established in fiscal year 1999 and covers all employees. Employer contributions are based on a percentage of employee contributions and certain other restrictions as defined in the plan document. In addition, the Company may also make discretionary contributions at the end of the plan year. Employer contributions of approximately \$263,000, \$378,000 and \$421,000 were expensed in the fiscal years ended June 30, 2001, 2000 and 1999, respectively.

Prior to fiscal year 2000, the Company had a profit sharing plan, which covered all employees who worked in excess of 1,000 hours per year. Minimum contributions were based on income before income taxes, subject to limitations based on employee compensation and certain other restrictions defined in the plan document.

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Contributions of approximately \$161,000 were expensed in the fiscal year ended June 30, 1999.

### NOTE 7 DEBT

On June 24, 1999, the Company entered into a revolving credit facility ("Credit Facility") with Mellon Bank N.A, totaling \$12.5 million and expiring on June 24, 2003. Proceeds from the Credit Facility were used to pay the outstanding balance (\$6.8 million at June 24, 1999) under the Company's loan facility with its

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previous primary lender. Borrowings are based on a formula of receivables and property as defined in the Credit Facility, however, the Company was in default of certain covenants at June 30, 2001. There was an outstanding balance under the Credit Facility as of June 30, 2001 of \$157,000.

Interest is payable monthly, in arrears, at a rate defined in the credit facility (8.0% at June 30, 2001.) The Company is required to pay certain fees on a quarterly basis as calculated by the bank. The unused line fee is equal to .50% per annum of the average daily unused balance. The agreement includes a letter of credit fee equal to .75% per annum and a standby letter of credit fee equal to 1.5% per annum. There were no outstanding letters of credit at June 30, 2001.

The Credit Facility includes certain covenants related to, among other things, working capital, tangible net worth, net income, cash flow and capital expenditures. In addition, the Company is not permitted to pay dividends and substantially all of the assets of the Company are pledged as collateral for the Credit Facility.

At June 30, 2001, the Company was not in compliance with certain financial covenants under the Company's Credit Facility. See note 16 in the Notes to the Consolidated Financial Statements. The Company is in the process of resolving the non-compliance issues by negotiating amended covenants and a reduced Credit Facility limit. Negotiations are expected to be completed by November 1, 2001. Based on the Company's positive cash balance since July 13, 2001, and the positive cash projections for the balance of fiscal year 2002, management believes that operational cash requirements can be funded internally.

The Credit Facility includes a subjective acceleration clause as well as a lockbox requirement under the control of the lender, whereby collections of trade receivables are used to immediately reduce the balance of the Credit Facility.

Under the former loan facility, interest was payable monthly, in arrears, at a rate defined in the agreement (ranging from 7.19% to 10.62% during fiscal year 1999). The Company was also required to pay fees on an annual basis as calculated by the lender. The revolving credit commitment fee was equal to .25% per annum on the total outstanding balance.

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### NOTE 8                      INCOME TAXES

The domestic and foreign components of income/(loss) before income taxes are presented below for the years ended June 30, (in thousands):

|                        | 2001<br>----- | 2000<br>----- | 1999<br>----- |
|------------------------|---------------|---------------|---------------|
| Continuing Operations: |               |               |               |
| Domestic               | \$ (6,979)    | \$ 3,389      | \$ (1,883)    |
| Foreign                | --            | --            | (2,734)       |
|                        | -----         | -----         | -----         |
| Total                  | \$ (6,979)    | \$ 3,389      | \$ (4,617)    |
|                        | =====         | =====         | =====         |



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The components of the benefit for income taxes are as follows for the years ended June 30, (in thousands):

|   | 2001<br>----   | 2000<br>----   | 1999<br>-----      |
|---|----------------|----------------|--------------------|
| Current:                                |                |                |                    |
| Federal                                 | \$ --          | \$ --          | \$ --              |
| State                                   | --             | --             | --                 |
|   | -----          | -----          | -----              |
| Subtotal                                | --             | --             | --                 |
|   | -----          | -----          | -----              |
| Deferred:                               |                |                |                    |
| Federal                                 | 160            | --             | (1,171)            |
| State                                   | --             | --             | 100                |
|   | -----          | -----          | -----              |
| Subtotal                                | 160            | --             | (1,071)            |
|   | -----          | -----          | -----              |
| Provision/(Benefit)<br>for Income Taxes | \$160<br>===== | \$ --<br>===== | \$(1,071)<br>===== |

The Company has cumulative federal net operating loss carryforwards of approximately \$12.3 million, which expire between 2019 and 2021. In addition, the Company had available at June 30, 2001, cumulative net operating loss carryforwards of \$12.8 million for Florida state income tax purposes, which expire between 2019 and 2021.

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The tax effects of the primary temporary differences giving rise to the Company's deferred tax assets and liabilities are as follows for the years ended June 30, (in thousands):

|   | 2001    |           | 2000    |           |
|---|---------|-----------|---------|-----------|
|   | Asset   | Liability | Asset   | Liability |
| Revenue Recognized on Completed Contract for<br>Tax Return and on Percentage of Completion for<br>Financial Reporting | \$ 104  | \$ --     | \$ --   | \$ 8      |
| Federal Operating Loss Carryforwards  | 4,183   | --        | 1,825   | --        |
| Federal Tax Credit Carryforwards  | 510     | --        | 393     | --        |
| State Tax Loss Carryforwards  | 705     | --        | 469     | --        |
| Difference between Book and Tax Depreciation  | 224     | --        | --      | 10        |
| Capitalized Bid and Proposal Expense  | 194     | --        | 651     | --        |
| Accruals Not Currently Deductible   | 1,148   | 61        | 1,062   | 62        |
|   | -----   | -----     | -----   | -----     |
| Subtotal  | 7,068   | 61        | 4,400   | 80        |
| Valuation Allowance   | (7,068) | --        | (4,382) | --        |
|   | -----   | -----     | -----   | -----     |
| Total   | \$ --   | \$ 61     | \$ 18   | \$ 80     |

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A valuation allowance provided at June 30, 2001 and 2000 relates primarily to federal and state net operating loss carryforwards which are subject to uncertainty as to their ultimate realization.

These deferred tax assets and liabilities are included in/or classified as follows on the Consolidated Balance Sheets for the years ended June 30, (in thousands):

|                               | 2001  | 2000  |
|-------------------------------|-------|-------|
|                               | ----  | ----  |
| Prepaid Expenses and Other    | \$ -- | \$ 18 |
| Accrued Expenses and Other    | \$ -- | \$ -- |
| Deferred Income Tax Liability | \$ 61 | \$ 80 |

Differences between the statutory U.S. Federal Income Tax rate and the effective income tax rate reported in the financial statements are as follows for continuing operations for the years ended June 30:

|  | 2001    | 2000    | 1999    |
|--|---------|---------|---------|
|  | -----   | -----   | -----   |
| Federal Statutory Rates                      | (34.0%) | 34.0%   | (34.0%) |
| Decrease/(Increase) in Taxes Resulting From: |         |         |         |
| State Income Taxes (after deducting          |         |         |         |
| Federal Income Tax Benefit)                  | 0.0%    | 1.3%    | 1.4%    |
| Valuation Allowance                          | 35.0%   | (34.9%) | 13.5%   |
| Other  | 1.3%    | (0.4%)  | (4.1%)  |
|  | -----   | -----   | -----   |
| Total Provision/(Benefit)                    |         |         |         |
| for Income Taxes                             | 2.3%    | --      | (23.2%) |
|  | =====   | =====   | =====   |

The tax benefit realized from the exercise of stock options was immaterial in fiscal years 2001, 2000 and 1999. These tax benefits were credited to Capital in Excess of Par.

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NOTE 9 FINANCIAL INSTRUMENTS

CONCENTRATIONS OF CREDIT RISK

Financial instruments, which potentially subject the Company to concentrations of credit risk consist principally of accounts receivables from major defense prime contractors and U.S. government agencies which minimizes the Company's credit risk. The Company generally does not require collateral or other security

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to support customer receivables.

### FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying values of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate their fair values because of the short maturity of these instruments. The fair value of the Company's debt approximates fair value due to the variable nature of the interest rate on the debt.

### NOTE 10 SHAREHOLDERS EQUITY

Due to the excess cash position and in order to enhance shareholder value, the Board of Directors authorized a common stock repurchase plan of up to \$3,000,000 during fiscal year 2001. A total of 727,000 shares of stock was repurchased for approximately \$2,909,000 and is reflected as Treasury Stock, which is accounted for at actual cost.

On August 27, 1996, the Board of Directors declared a dividend distribution of one Right (a "Right") for each outstanding share of the Company's Common Stock to stockholders of record at the close of business on September 17, 1996. Each Right entitles the registered holder to purchase from the Company one one-thousandth of a share (a "Unit") of Series B Junior Participating Preferred Stock, \$0.10 par value per share at a purchase price of \$40.00 per Unit, subject to adjustment. The description and terms of the Rights are set forth in a Rights Agreement dated August 27, 1996 between the Company and Mellon Bank, N.A. as Rights Agent, as amended (the "Rights Agreement"). On August 9, 2000, the Board of Directors terminated the Rights Agreement and, as required under the Rights Agreement, on September 1, 2000, stockholders of record at the close of business on August 9, 2000 received \$0.01 for each Right held.

### NOTE 11 STOCK COMPENSATION

The Company has several stock-based compensation plans, which are described below. The Company's Organization and Compensation Committee administers all the stock benefit plans of the Company. The Company applies APB Opinion No. 25 and related Interpretations in accounting for its plans. Since stock option exercise prices are equal to the fair market value of the stock on the date of grant for its fixed stock option plans and equal to 85% of the fair market value on the date of exercise for stock issued under the employee stock purchase plans, compensation expense is not recognized. However, had compensation cost for the Company's stock-based compensation plans been determined based on the fair value of the options at the grant dates for awards under those plans consistent with the method of SFAS No. 123, the Company's net income/(loss) and net income/(loss) per share for fiscal years 2001, 2000 and 1999 would have been changed to the pro-forma amounts indicated below (in thousands, except per share data):

|                                     | 2001<br>----- | 2000<br>----- | 1999<br>----- |
|-------------------------------------|---------------|---------------|---------------|
| Net Income/(Loss)                   | \$ (7,367)    | \$ 3,251      | \$ (4,027)    |
| Net Income/(Loss) Per Share-Basic   | \$ (0.92)     | \$ 0.39       | \$ (0.48)     |
| Net Income/(Loss) Per Share-Diluted | \$ (0.92)     | \$ 0.38       | \$ (0.48)     |

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In accordance with FAS Statement 123, "Accounting for Stock-Based Compensation", the pro-forma calculations do not include the effects of options granted prior to fiscal year 1996. As such, the impact is not necessarily indicative of the effects on reported net income in future years.

The fair value of options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions:

|                          | 2001<br>----- | 2000<br>----- | 1999<br>----- |
|--------------------------|---------------|---------------|---------------|
| Expected Dividend Yield  | 0.00%         | 0.00%         | 0.00%         |
| Risk-free Interest Rate  | 6.22%         | 5.49%         | 4.61%         |
| Expected Volatility      | 40.18%        | 41.59%        | 49.10%        |
| Expected Life (in years) | 6.00          | 6.00          | 3.00          |

There were 152,500, 215,000 and 65,586 options granted during fiscal years 2001, 2000 and 1999, respectively, with weighted average fair values of \$1.70 in 2001, \$1.80 in 2000 and \$2.29 in 1999.

Under the Company's 1998 Stock Incentive Plan, directors, officers and certain key employees may purchase the Company's Common Stock at 100% of the fair market value of the shares on the date of grant. Vesting of options is determined by the Board of Directors. Generally, options granted based on performance in the previous fiscal year are exercisable on the date granted. Options granted to provide an incentive for future performance are exercisable one year from the date granted. All options expire ten years from the date granted. There were 600,000 shares reserved for issuance under the 1998 Plan. There were 152,500, 185,000 and 60,586 options granted under the plan during fiscal years 2001, 2000 and 1999, respectively.

Under the Company's 1991 Stock Incentive Plan, directors, officers and key employees were granted the right to purchase the Company's Common Stock at 100% of fair market value of the shares on the date of the grant. Unless the Board of Directors determined otherwise, 20% of the options granted under the Plan were exercisable one year from the date the option was granted. An additional 20% was exercisable each year thereafter. All options expire upon the earlier of 10 years and 30 days from date of grant or, with respect to shares covered by such options, five years from the date the option first became exercisable. The 1991 Plan expired in 2001. No additional options can be granted pursuant to the Plan. There were 30,000 and 5,000 options granted under the 1991 Plan during fiscal years 2000 and 1999, respectively. A summary of stock option transactions for the fiscal years ended June 30, 2001, 2000 and 1999 are as follows:

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|                          | Shares Under<br>Option<br>----- | Weighted Average<br>Exercise Price<br>----- |
|--------------------------|---------------------------------|---|
| Balance at June 30, 1998 | 1,027,036                       | \$ 8.02                                     |

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|                          |           |         |
|--------------------------|-----------|---------|
| Options Granted          | 65,586    | 2.29    |
| Options Exercised        | (2,000)   | 2.13    |
| Options Terminated       | (297,554) | 10.17   |
|                          | -----     | -----   |
| Balance at June 30, 1999 | 793,068   | \$ 6.75 |
| Options Granted          | 215,000   | 3.71    |
| Options Exercised        | (3,400)   | 2.13    |
| Options Terminated       | (94,195)  | 10.77   |
|                          | -----     | -----   |
| Balance at June 30, 2000 | 910,473   | \$ 5.63 |
| Options Granted          | 152,500   | 3.47    |
| Options Exercised        | (54,337)  | 3.15    |
| Options Terminated       | (143,800) | 9.03    |
|                          | -----     | -----   |
| Balance at June 30, 2001 | 864,836   | \$ 4.84 |
|                          | =====     | =====   |

Options exercisable were 804,836, 735,473 and 603,798 at June 30, 2001, 2000 and 1999, respectively.

Stock options outstanding at June 30, 2001 are summarized as follows:

| Range of<br>Exercise Prices | Number<br>Outstanding | Weighted Average<br>Remaining<br>Contractual Life | Weighted<br>Average<br>Exercise Price | Number<br>Exercisable | Weighted<br>Average<br>Exercise Price |
|-----------------------------|-----------------------|---|---------------------------------------|-----------------------|---------------------------------------|
| -----                       | -----                 | -----   | -----                                 | -----                 | -----                                 |
| \$1.15-2.30                 | 28,586                | 7 years   | \$ 1.82                               | 28,586                | \$ 1.82                               |
| \$2.30-3.45                 | 382,500               | 7 years   | \$ 3.15                               | 382,500               | \$ 3.15                               |
| \$3.45-4.60                 | 290,000               | 8 years   | \$ 3.77                               | 230,000               | \$ 3.82                               |
| \$9.20-10.35                | 22,000                | 5 years   | \$ 10.00                              | 22,000                | \$ 10.00                              |
| \$10.35-11.50               | 141,750               | 4 years   | \$ 11.41                              | 141,750               | \$ 11.41                              |

The Company currently maintains an Employee Stock Purchase Plan which is intended to provide eligible employees with an opportunity to purchase the Company's Common Stock through payroll deductions at eighty-five percent of the market price on specified dates. The Stockholders approved the 1999 Employee Stock Purchase Plan during fiscal year 1999 reserving 360,000 shares for issuance under this plan. In prior years, the Company maintained several Employee Stock Purchase Plans, which were the same in all respects to the current plan, including the number of shares reserved. Shares issued under the previous Employee Stock Purchase plans during fiscal years ended June 30, 2001, 2000, and 1999, were 17,529, 38,291 and 59,349, respectively. The fair value of shares issued during fiscal years 2001, 2000 and 1999 were \$0.65, \$0.94 and \$0.78 share, respectively. The fair value of these shares was estimated using a Black-Scholes Option pricing model with the following weighted average assumptions for fiscal years:

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2001                      2000                      1999

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|                           | -----  | -----  | -----  |
|---------------------------|--------|--------|--------|
| Expected Dividend Yield   | 0.00%  | 0.00%  | 0.00%  |
| Risk-free Interest Rate   | 6.22%  | 5.49%  | 4.61%  |
| Expected Volatility       | 40.18% | 41.59% | 49.10% |
| Expected Life (in months) | 6      | 6      | 3      |

The Company has available 1,000,000 authorized and unissued shares of \$0.10 par value Preferred Stock. Shares may be issued from time to time in one or more series, each series having such special rights, privileges and preferences as may be determined by the Board of Directors at the time of issuance.

During fiscal year 1998, the Board of Directors and Stockholders approved a Director Equity Compensation Plan. Under the Plan, the members of the Company's Board of Directors can choose to receive unrestricted shares of the Company's Common Stock in lieu of 50% of the otherwise payable directors' fees. A total of 75,000 shares of Common Stock were reserved for issuance under the Plan. During fiscal year 2000, the Board of Directors approved an additional 50,000 shares of the Company's Common Stock for issuance under the Plan. During fiscal years 2001, 2000 and 1999, 4,354, 27,211 and 32,558 shares, respectively, were issued under this Plan.

On June 15, 1998, the Company entered into a Stock Purchase Agreement with its Chief Executive Officer (CEO). In connection with this agreement, the CEO purchased 50,000 shares of common stock. The CEO paid \$10,000 cash and issued a non-recourse Promissory Note to the Company in the amount of \$146,250 in payment of the shares. The Promissory Note bears an interest rate of 5.58% and was repayable together with interest on June 15, 2001. On May 3, 2001, the Company extended the Employment Agreement with the CEO and the maturity date of the Promissory Note to July 1, 2002. At that time, the accrued interest was added to the Note resulting in a balance of \$168,004 at June 30, 2001.

As a result of the note receivable and related accrued interest being non-recourse to the CEO, the sale of stock has been treated as variable stock compensation arrangement. Compensation expense relating to the arrangement was not material in fiscal year 1999, 2000 or 2001.

NOTE 12 BUSINESS SEGMENT INFORMATION

The Company operates in one segment; training. This segment includes the design and manufacture of training simulators.

SALES BY CLASS OF CUSTOMER

|                                  | (In Thousands) |          |          |
|----------------------------------|----------------|----------|----------|
|                                  | 2001           | 2000     | 1999     |
|                                  | -----          | -----    | -----    |
| U.S. Department of Defense       |                |          |          |
| Direct                           | \$11,847       | \$ 4,562 | \$ 5,734 |
| Subcontract                      | 16,878         | 36,314   | 35,696   |
|                                  | -----          | -----    | -----    |
| Total U.S. Department of Defense | 28,725         | 40,876   | 41,430   |

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|                         |          |          |          |
|-------------------------|----------|----------|----------|
| Foreign Governments     | 11       | --       | 5,147    |
| Foreign Commercial      | --       | --       | 2,099    |
| Total Foreign and Other | 11       | --       | 7,246    |
| Total Sales             | \$28,736 | \$40,876 | \$48,676 |

Export Sales from the U.S. were not material for the fiscal year ended June 30, 2001, 2000 and 1999. Export sales do not include Foreign Military Sales through U.S. Government agencies and prime contractors of \$416,000 and \$911,000 in the fiscal years ended June 30, 2000 and 1999, respectively. There were no Foreign Military Sales in the fiscal year ended June 30, 2001.

Since the substantial portion of the Company's revenue is attributable to long term contracts with various government agencies, any factor affecting procurement of long term government contracts, such as changes in government spending, cancellation of weapons programs and delays in contract award could have a material adverse effect on the Company's financial condition and results of operations.

In fiscal year 2001, sales to Raytheon/Lockheed Martin JAVELIN Joint Venture (the "Joint Venture") and Lockheed Martin Corporation ("Lockheed") were \$7.4 million or 26% of total sales and \$6.2 million or 22% of total sales, respectively. In fiscal year 2000, sales to the Joint Venture, Lockheed and The Boeing Company ("Boeing") were \$12.1 million or 30% of total sales, \$11.8 million or 29% of total sales, and \$10.3 million or 25% of total sales, respectively.

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In fiscal year 1999, sales to the Joint Venture, Lockheed and Boeing were \$20.2 million or 41% of total sales, \$8.0 million or 16% of total sales, and \$8.5 Million or 17% of total sales, respectively.

SALES BY GEOGRAPHIC AREA

|                         | United States | (In Thousands)<br>Europe and Middle East | Consolidated |
|-------------------------|---------------|--|--------------|
|                         | -----         | -----                                    | -----        |
| Revenues                |               |  |              |
| 2001                    | \$ 28,736     | \$ --                                    | \$ 28,736    |
| 2000                    | 40,876        | --                                       | 40,876       |
| 1999                    | 41,439        | 7,237                                    | 48,676       |
| Operating Income/(Loss) |               |  |              |
| 2001                    | \$ (6,876)    | \$ --                                    | \$ (6,876)   |
| 2000                    | 3,985         | --                                       | 3,985        |
| 1999                    | (1,942)       | (1,932)                                  | (3,874)      |
| Long-Lived Assets       |               |  |              |
| 2001                    | \$ 13,352     | \$ --                                    | \$ 13,352    |
| 2000                    | 15,476        | --                                       | 15,476       |
| 1999                    | 18,273        | --                                       | 18,273       |

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NOTE 13

### SUMMARY OF QUARTERLY RESULTS (UNAUDITED)

|  | (In Thousands Except Per Share Data) |                |             |            |
|--|--------------------------------------|----------------|-------------|------------|
| 2001   | September<br>30                      | December<br>31 | March<br>31 | June<br>30 |
| -----  | -----                                | -----          | -----       | -----      |
| Net Sales  | \$ 7,471                             | \$ 7,548       | \$ 5,749    | \$ 7,968   |
| Gross Profit   | 2,159                                | 394            | 863         | 585        |
| Operating Loss   | (110)                                | (1,880)        | (1,886)     | (3,000)    |
| Net Income/(Loss)  | 9                                    | (2,020)        | (2,055)     | (3,073)    |
| Income Per Common Share -<br>Basic and Assuming Dilution |                                      |                |             |            |
| Basic  | --                                   | (0.25)         | (0.26)      | (0.38)     |
| Dilutive   | --                                   | (0.25)         | (0.26)      | (0.38)     |

As a result of the periodic review of estimated costs at completion and consideration of changes in facts and circumstances, revisions were made to the estimated cost to complete for certain contracts in the second and fourth quarters of fiscal year 2001. Gross margin adjustments on contracts resulted in a reduction to income of approximately \$700,000 during the second quarter and additional income of approximately \$500,000 during the fourth quarter of fiscal year 2001.

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In addition, a \$657,000 reserve for doubtful accounts and a \$1,041,000 reserve for excess and obsolete inventory were recorded in the fourth quarter of fiscal year 2001. See Notes 2 and 3 to the Consolidated Financial Statements.

|  | (In Thousands Except Per Share Data) |                |             |            |
|--|--------------------------------------|----------------|-------------|------------|
| 2000   | September<br>30                      | December<br>31 | March<br>31 | June<br>30 |
| -----  | -----                                | -----          | -----       | -----      |
| Net Sales  | \$10,188                             | \$11,058       | \$9,888     | \$9,742    |
| Gross Profit   | 2,963                                | 3,668          | 3,930       | 2,929      |
| Operating Income   | 898                                  | 1,241          | 1,459       | 387        |
| Net Income   | 573                                  | 1,058          | 1,310       | 448        |
| Income Per Common Share -<br>Basic and Assuming Dilution |                                      |                |             |            |
| Basic  | \$ 0.07                              | \$ 0.13        | \$ 0.16     | \$ 0.05    |
| Dilutive   | \$ 0.07                              | \$ 0.12        | \$ 0.15     | \$ 0.05    |

As a result of the periodic review of estimated costs at completion and consideration of changes in facts and circumstances, revisions were made in the estimated costs to complete for certain contracts in the second and third quarters of fiscal year 2000. Gross margin adjustments on contracts resulted in a reduction to income of approximately \$200,000 during the second quarter and additional income of approximately \$1.0 million during the third quarter of fiscal year 2000.

NOTE 14

### COMMITMENTS AND CONTINGENCIES



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The Company and its subsidiaries lease certain equipment under operating leases. Future minimum lease payments under all non-cancelable operating leases as of June 30, 2001 are as follows:

|                              | (In Thousands) |
|------------------------------|----------------|
|                              | -----          |
| 2002                         | \$ 59          |
| 2003                         | 46             |
| 2004                         | 25             |
|                              | -----          |
| Total Minimum Lease Payments | \$ 130         |
|                              | =====          |

Rent expense under all operating leases was approximately \$435,000, \$456,000 and \$970,000 for the fiscal years ended June 30, 2001, 2000 and 1999, respectively.

During fiscal year 2001, the Company announced the formation of a strategic planning committee to evaluate various strategic alternatives for enhancing stockholder value including a potential sale of the Company. In order to retain critical employees, retention agreements were implemented with 30 key employees whereby an incentive of 15-20% of their salaries would be payable in two increments: half at the date of the sale of the Company and half six months after the close of the sale.

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These payments totaling \$500,000 will be recorded in the event the Company is sold.

The Company is party to various legal proceedings arising from normal business activity. Management believes that the ultimate resolution of these matters will not have an adverse material effect on the Company's financial condition or results of operations.

### NOTE 15 UNUSUAL EXPENSES

During the first quarter of fiscal year 1999, the Board of Directors announced the approval of a plan to wind-down and discontinue the U.K. operation. The U.K. operation wind-down was completed in May 1999. In addition, on September 30, 1998, the Company relocated its corporate headquarters from Wayne, Pennsylvania to Orlando, Florida. As a result of the efforts to wind-down the U.K. operation and the relocation of the corporate headquarters, the Company recorded non-recurring charges of approximately \$3.5 million (after the effect of writing off the U.K. operation's cumulative translation adjustment of \$267,000) in fiscal year 1999. These charges primarily relate to employee termination benefits and lease termination costs.

The following table sets forth the details and the cumulative activity in the various accruals associated with the wind down of the U.K. operation and relocation of the corporate headquarters in the Consolidated Balance Sheet at June 30, 1999, June 30, 2000 and June 30, 2001 (in thousands):

Facility

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|                   | Severance | Lease<br>Obligation | Other  | Total    |
|-------------------|-----------|---------------------|--------|----------|
|                   | -----     | -----               | -----  | -----    |
| Incurring in 1999 | \$ 2,249  | \$ 1,408            | \$ 212 | \$ 3,869 |
| Cash Reductions   | (2,205)   | (834)               | (14)   | (3,053)  |
| Non-Cash Activity | --        | (7)                 | (40)   | (47)     |
| Reversal          | (8)       | --                  | (142)  | (150)    |
|                   | -----     | -----               | -----  | -----    |
| Balance 6/30/99   | 36        | 567                 | 16     | 619      |
| Cash Reductions   | (36)      | (436)               | (16)   | (488)    |
| Non-Cash Activity | --        | 11                  | --     | 11       |
|                   | -----     | -----               | -----  | -----    |
| Balance 6/30/00   | --        | 142                 | --     | 142      |
| Cash Reductions   | --        | (140)               | --     | (140)    |
| Non-Cash Activity | --        | (2)                 | --     | (2)      |
|                   | -----     | -----               | -----  | -----    |
| Balance 6/30/01   | \$ --     | \$ --               | \$ --  | \$ --    |
|                   | =====     | =====               | =====  | =====    |

During fiscal year 2001, the Company reduced its operating costs by eliminating approximately 45 employees or 15% of the total number of employees during the first quarter and 60 employees or 24% of the total number of employees during the second quarter. Termination benefits associated with the reductions were approximately \$517,000 in the first quarter and approximately \$901,000 in the second quarter.

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Annual compensation costs associated with these actions were \$1,500,000 and \$2,800,000, respectively. All employee termination benefits were paid by June 30, 2001, with the exception of \$105,000, which is included in Accrued Expenses and Other.

NOTE 16 LIQUIDITY

At June 30, 2001, the Company was not in compliance with certain financial covenants under the Company's Credit Facility. See note 7 in the Notes to the Consolidated Financial Statements. The Company is in the process of resolving the non-compliance issues by negotiating amended covenants and a reduced Credit Facility limit. Negotiations are expected to be completed by November 1, 2001. Based on the Company's positive cash balance since July 13, 2001, and the positive cash projections for the balance of fiscal year 2002, management believes that operational cash requirements can be funded internally.

ITEM 9 CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

The Company has nothing to report under this item.

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PART III

ITEM 10 DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information concerning directors required by Item 10 is included under the

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caption "Election of Directors" in the Company's definitive Proxy Statement (the "2001 Proxy Statement") to be filed pursuant to Regulation 14A on or before October 29, 2001, and that information is incorporated by reference in this Form 10-K. Information concerning executive officers required by Item 10 is located at the end of Part I of this Form 10-K under the caption "Executive Officers and Key Management Employees of the Registrant."

### ITEM 11 EXECUTIVE COMPENSATION

The information required by Item 11 is included under the subcaption "Directors' Compensation" and in the text and tables under the caption "Executive Compensation" in the 2001 Proxy Statement, and that information is incorporated by reference in this Form 10-K.

### ITEM 12 SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by Item 12 is included under the caption "Security Ownership of Certain Beneficial Owners and Management" in the 2001 Proxy Statement, and that information is incorporated by reference in this Form 10-K.

### ITEM 13 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

None.

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## PART IV

### ITEM 14 EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

#### (a) (1) and (2) Financial Statements

The financial statements filed as part of this Annual Report are listed in the Index to Consolidated Financial Statements on page 14. Schedules other than those so listed are omitted for the reason that they are either not applicable or not required or because the information required is contained in the consolidated financial statements or notes thereto.

#### (3) Exhibits

### EXHIBIT INDEX

| EXHIBIT NO. | DESCRIPTION  |
|-------------|--|
| -----       | -----  |
| 3.1         | Certificate of Incorporation(4)  |
| 3.2         | By-Laws(1)   |
| 4.1         | Form of Common Stock Certificate(4)                                      |
| 10.3*       | Educational Computer Corporation 1986 Non-Qualified Stock Option Plan(4) |
| 10.4*       | ECC International Corp. 1991 Option Plan(3)                              |

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- 10.5\* Form of Stock Option Agreement for outside directors.(6)
- 10.8\* Form of Director's and Officer's Agreement to Defend and Indemnify.(2)
- 10.10 Overdraft Facility dated as of April 3, 1995 by and among ECC Simulation Limited and First Fidelity Bank, N.A., London Branch.(7)
- 10.12 Lease between ECC International Corp and State of Wisconsin Investment Board for the premises 2900 Titan Row, Orlando, Florida.(5)
- 10.16\* ECC International Corp Executive Savings Plan.(5)
- 10.23\* Director Equity Compensation Plan(8)
- 10.28\* 1998 Stock Incentive Plan.(10)
- 10.30\* Stock Purchase Agreement dated as of June 15, 1998 by and between the Company and James C. Garrett.(10)
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- 10.31\* Promissory Note dated as of June 15, 1998 by and between the Company and James C. Garrett.(10)
- 10.32\* Consulting Agreement dated as of April 1, 1998 by and between the Company and George W. Murphy.(10)
- 10.33\* Non-Competition and Non-Solicitation Agreement dated as of April 1, 1998 by and between the Company and George W. Murphy.(10)
- 10.37 Loan and Security Agreement dated June 24, 1999 by and between the Company and Mellon Bank, N.A.(11)
- 10.38 1999 Employee Stock Purchase Plan.(12)
- 10.39 Agreement dated September 16, 1999 by and between the Company, Steel Partners II, L.P. and Warren G. Lichtenstein.(13)
- 10.41\* Amendment and Restated Non-Competition and Non-Solicitation Agreement dated August 9, 1999 by and between the Company and James C. Garrett.(13)
- 10.42\* Employment Agreement dated August 9, 1999 by and between the Company and Glenn Andrew.(13)
- 10.43\* Non-Competition and Non-Solicitation Agreement dated August 9, 1999 by and between the Company and Glenn Andrew.(13)
- 10.44\* Employment Agreement dated August 9, 1999 by and between the Company and Melissa Van Valkenburgh.(13)
- 10.45\* Non-Competition and Non-Solicitation Agreement dated August 9, 1999 by and between the Company and Melissa Van

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|        |   |
|--------|---|
|        | Valkenburgh.(13)  |
| 10.46* | Employment Agreement dated May 3, 2001 by and between the Company and James C. Garrett.(13) |
| 10.47* | Change of Control Contract dated May 3, 2001 by and the Company and James C. Garrett.(14)   |
| 21     | Subsidiaries of the Registrant.(9)  |
| 23     | Consent of PricewaterhouseCoopers, LLP.   |
| 27     | Financial Data Schedule.  |
| *      | Management contract or other compensatory plan or arrangement.                              |
| 1      | Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for             |

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|    |   |
|----|---|
|    | the quarter ended December 31, 1996. (Commission File No. 001-8988)   |
| 2  | Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 1996. (Commission File No. 001-8988)        |
| 3  | Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended June 30, 1991. (Commission File No. 001-8988)               |
| 4  | Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended June 30, 1993. (Commission File No. 001-8988)               |
| 5  | Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 1995. (Commission File No. 001-8988)     |
| 6  | Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended June 30, 1994. (Commission File No. 001-8988)               |
| 7  | Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended June 30, 1995. (Commission File No. 001-8988)               |
| 8  | Incorporated by reference to Annex A of the Registrant's Definitive Schedule 14A filed with the SEC on October 27, 1997. (Commission File No. 001-8988) |
| 9  | Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended June 30, 1997. (Commission File No. 001-8988)               |
| 10 | Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended June 30, 1998. (Commission File No. 001-8988)               |
| 11 | Incorporated by reference to the Registrant's Current Report on Form 8-K filed July 8, 1999. (Commission File No. 001-8988)                             |

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- 12 Incorporated by reference to the Registrant's Definitive Schedule 14A filed on October 28, 1998. (Commission File No. 001-8988)
- 13 Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 1999. (Commission File No. 001-8988)
- 14 Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2001. (Commission File No. 001-8988)

(B) REPORTS ON FORM 8-K

None.

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Schedule II-Valuation and Qualifying Accounts  
For the Years Ended June 30, 2001, 2000, and 1999  
(In Thousands)

| Description                                 | Beginning Balance | Additions                     |                           | Deductions | Ending Balance |
|---|-------------------|-------------------------------|---------------------------|------------|----------------|
|   |                   | Charged to Costs and Expenses | Charged to Other Accounts |            |                |
| Inventory Reserve                           |                   |                               |                           |            |                |
| 1999  | \$ 110            | \$ 398                        | \$ --                     | \$ --      | \$ 508         |
| 2000  | 508               | 2,080                         | --                        | (424)      | \$2,164        |
| 2001  | 2,164             | 1,282                         | --                        | (634)      | \$2,812        |
| Allowance for Doubtful Accounts             |                   |                               |                           |            |                |
| 1999  | --                | --                            | --                        | --         | --             |
| 2000  | --                | --                            | --                        | --         | --             |
| 2001  | --                | 657                           | --                        | --         | 657            |
| Valuation Allowance for Deferred Tax Assets |                   |                               |                           |            |                |
| 1999  | 4,857             | 711                           | --                        | --         | 5,568          |
| 2000  | 5,568             | --                            | --                        | (1,186)    | 4,382          |
| 2001  | \$4,382           | \$2,686                       | \$ --                     | \$ --      | 7,068          |

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ECC INTERNATIONAL CORP.

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By: /s/ Melissa Van Valkenburgh

-----  
Melissa Van Valkenburgh, Vice President, Finance

Date: October 11, 2001  
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Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated, by a majority of the Board of Directors.

|  |   |                  |
|--|---|------------------|
| /s/ James C. Garrett   | ) |                  |
| -----  | ) |                  |
| James C. Garrett, President, Chief Executive Officer and Principal Executive Officer | ) |                  |
|  | ) |                  |
|  | ) |                  |
| /s/ Julian Demora  | ) |                  |
| -----  | ) |                  |
| Julian Demora, Director  | ) |                  |
|  | ) |                  |
|  | ) |                  |
| /s/ James Henderson  | ) |                  |
| -----  | ) |                  |
| James Henderson, Director  | ) |                  |
|  | ) |                  |
|  | ) |                  |
| /s/ Jesse Krasnow  | ) |                  |
| -----  | ) |                  |
| Jesse Krasnow, Director  | ) | October 11, 2001 |
|  | ) |                  |
|  | ) |                  |
| /s/ Warren Lichtenstein  | ) |                  |
| -----  | ) |                  |
| Warren Lichtenstein, Director  | ) |                  |
|  | ) |                  |
|  | ) |                  |
| /s/ Merrill A. McPeak  | ) |                  |
| -----  | ) |                  |
| Merrill A. McPeak, Director  | ) |                  |
|  | ) |                  |
|  | ) |                  |
| /s/ Robert F. Mehmel   | ) |                  |
| -----  | ) |                  |
| Robert F. Mehmel, Director   | ) |                  |
|  | ) |                  |
|  | ) |                  |
| /s/ Melissa Van Valkenburgh  | ) |                  |
| -----  | ) |                  |
| Melissa Van Valkenburgh, Principal Financial Officer                                 | ) |                  |

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DIRECTORS

Julian J. Demora  
President  
Key Realty Development, Inc.  
Hollywood, Florida

James C. Garrett  
President  
ECC International Corp.  
Orlando, Florida

James R. Henderson  
Vice President of Operations  
Steel Partners, LLP  
New York, New York

Jesse L. Krasnow  
Partner: Lefferts Fore Associates  
New York, New York

Warren G. Lichtenstein  
President  
Steel Partners, LLP  
New York, New York

Merrill A. McPeak  
General USAF (Retired)  
President  
McPeak & Associates  
Lake Oswego, Oregon

Robert F. Mehmel  
DRS Technology  
Parsippany, NJ

OFFICERS

James C. Garrett  
President and Chief  
Executive Officer

Glenn C. Andrew  
Executive Vice President

Melissa A. Van Valkenburgh  
Vice President, Finance,  
Chief Financial Officer,  
Secretary/Treasurer

Steve Stankiewicz  
Vice President, Business  
Development

CORPORATE INFORMATION  
ECC International Corp.  
2001 West Oak Ridge Road  
Orlando, FL 32809-3803  
(407) 859-7410

Transfer Agent and Registrar  
Mellon Investor Services  
P.O. Box 590  
Ridgefield Park, NJ 07660  
[www.chasemellon.com](http://www.chasemellon.com)

Independent Accountants  
PricewaterhouseCoopers, LLP  
390 N. Orange Avenue  
Suite 2400  
Orlando, FL 32801

CORPORATE COUNCEL

Olshan, Grundman, Frome,  
Rosenzweig & Wolosky, LLP  
505 Park Ave, 17th Floor  
New York, NY 10022

ANNUAL MEETING

The 2001 Annual Meeting  
will be held November 30,  
2001 at:  
ECC International Corp.  
2001 West Oak Ridge Rd  
Orlando, FL 32809-3803

ADDITIONAL INFORMATION

Copies of the Company's  
Annual Report can be  
obtained without charge by  
writing to:

INVESTOR RELATIONS

ECC International Corp.  
2001 West Oak Ridge Road  
Orlando, FL 32809-3803