DYNCORP INTERNATIONAL INC.
Form 10-Q
November 13, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 29, 2006
or

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

For the transition period from to

Commission File Number: 001-32869

DYNCORP INTERNATIONAL INC.
(Exact name of registrant as specified in its charter)

Delaware	**01-0824791**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3190 Fairview Park Drive, Suite 350, Falls Church, Virginia 22042
(571) 722-0210

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer o Non-accelerated filer x

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

As of November 5, 2006, the registrant had 57,000,000 shares of its Class A common stock, par value $0.01 per share, outstanding.

DYNCORP INTERNATIONAL INC.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

DYNCORP INTERNATIONAL INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)
(Unaudited)

	September 29, 2006	March 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 80,439	$ 20,573
Receivables, net of allowances for doubtful accounts of $3,428 and $8,479 at September 29, 2006 and March 31, 2006, respectively	415,967	440,195
Prepaid expenses and other current assets	54,020	43,733
Deferred tax asset	4,509	795
Total current assets	554,935	505,296
Property and equipment at cost, less accumulated depreciation of $2,134 and $1,296 at September 29, 2006 and March 31, 2006, respectively	11,561	8,769
Other assets:		
Goodwill	420,180	420,180
Tradename	18,318	18,318
Customer-related intangibles, net of accumulated amortization of $63,267 and $43,471 at September 29, 2006 and March 31, 2006, respectively	227,114	246,910
Deferred financing costs, net of accumulated amortization of $4,616 and $3,261 at September 29, 2006 and March 31, 2006, respectively	15,656	17,469
Other intangibles, net of accumulated amortization of $5,571 and $3,671 at September 29, 2006 and March 31, 2006, respectively	6,939	7,453
Deferred income taxes	14,413	11,518
Other assets	2,149	3,176
Total other assets	704,769	725,024
Total assets	$ 1,271,265	$ 1,239,089
Liabilities and Shareholders Equity		
Current liabilities:		
Current portion of long-term debt	$ 3,450	$ 2,588
Current portion of other long-term liabilities	301	
Accounts payable and accrued expenses	152,797	143,668
Accrued payroll and employee costs	76,693	65,586
Other accrued liabilities	56,609	33,845
Income taxes payable	2,407	8,280
Total current liabilities	292,257	253,967
Long-term debt less current portion	629,270	658,963
Other long-term liabilities	2,563	
Shares subject to mandatory redemption Series A preferred stock, stated value $195,550; 350,000 shares authorized; 190,550 shares issued and outstanding; redemption value of $219,821 at March 31, 2006; and no shares outstanding at September 29, 2006		219,821
Commitments and contingencies		
Shareholders equity:		
Preferred stock, $0.01 par value 50,000 shares authorized; no shares outstanding		
Common stock, $0.01 par value 232,000 shares and 32,000 shares authorized; 57,000 shares and 32,000 shares issued and outstanding at September 29, 2006 and March 31, 2006, respectively	570	320
Additional paid-in capital	350,360	102,097
Retained (deficit) earnings	(3,497)	4,139
Accumulated other comprehensive loss	(258)	(218)
Total shareholders equity	347,175	106,338
Total liabilities and shareholders equity	$ 1,271,265	$ 1,239,089

See notes to condensed consolidated financial statements.

DYNCORP INTERNATIONAL INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE AND SIX MONTHS ENDED SEPTEMBER 29, 2006 AND SEPTEMBER 30, 2005
(In thousands, except per share data)

	For the Three Months Ended Sept. 29, 2006 (unaudited)	Sept. 30, 2005	For the Six Months Ended Sept. 29, 2006 (unaudited)	Sept. 30, 2005
Revenues	$ 474,721	$ 439,629	$ 1,012,405	$ 864,684
Costs of services (excluding depreciation and amortization disclosed below)	423,433	385,002	893,767	763,592
Selling, general and administrative	30,552	19,702	57,957	38,861
Depreciation and amortization	11,212	11,515	22,349	22,200
Operating income	9,524	23,410	38,332	40,031
Other expense (income):				
Interest expense	14,689	13,855	29,503	27,684
Interest on mandatory redeemable shares		4,195	3,002	8,246
Loss on debt extinguishment and preferred stock			9,201	
Loss (income) from joint ventures	123	73	(323)	141
Interest income	(410)	(61)	(560)	(54)
(Loss) income before income taxes	(4,878)	5,348	(2,491)	4,014
Income tax (benefit) provision	(1,998)	3,524	1,006	4,163
Net (loss) income	$ (2,880)	$ 1,824	$ (3,497)	$ (149)
(Loss) earnings per common share:				
Basic and diluted	$ (0.05)	$ 0.06	$ (0.07)	$ 0.00
Average common shares outstanding:				
Basic and diluted	57,000	32,000	52,467	32,000

See notes to condensed consolidated financial statements.

DYNCORP INTERNATIONAL INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED SEPTEMBER 29, 2006 AND SEPTEMBER 30, 2005
(In thousands)

	For the Six Months Ended Sept. 29, 2006 (unaudited)	Sept. 30, 2005
Cash flows from operating activities:		
Net loss	$ (3,497)	$ (149)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	23,515	22,616
Premium paid on redemption of senior subordinated notes	2,657	
Premium paid on redemption of preferred stock	5,717	
Deferred financing cost amortization	2,342	1,320
Non-cash interest expense (redeemable preferred stock dividend)		8,246
(Recovery) provision for losses on accounts receivable	(4,563)	350
Income from equity joint ventures	(334)	45
Deferred income taxes	(6,609)	(442)
Compensation expense related to Class B equity participation	999	
Loss (gain) on disposition of assets	7	(1)
Changes in current assets and liabilities:		
Accounts receivable	28,791	98,156
Prepaid expenses and other current assets	(4,599)	(2,640)
Accounts payable and accruals	30,931	(36,731)
Redeemable preferred stock dividend	(3,695)	
Income taxes payable	(5,854)	1,002
Net cash provided by operating activities	65,808	91,772
Cash flows from investing activities:		
Purchase of property and equipment	(2,671)	(697)
Proceeds from sale of property and equipment		11
Payment for computer software upgrade	(1,386)	
Other assets	(363)	(1,283)
Net cash used in investing activities	(4,420)	(1,969)
Cash flows from financing activities:		
Proceeds from equity offering, net	346,446	
Redemption of preferred stock	(216,126)	
Special dividend	(100,000)	
Premium paid on redemption of senior subordinated notes	(2,657)	
Premium paid on redemption of preferred stock	(5,717)	
Payment of deferred financing costs	(529)	
Borrowings related to prepaid insurance, net	5,892	
Payment on acquisition debt		(1,725)
Payments on credit facility	(28,831)	(35,000)
Purchase of interest rate cap		(483)
Net cash used in financing activities	(1,522)	(37,208)
Net increase in cash and cash equivalents	59,866	52,595
Cash and cash equivalents, beginning of period	20,573	13,474
Cash and cash equivalents, end of period	$ 80,439	$ 66,069

See notes to condensed consolidated financial statements.

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DYNCORP INTERNATIONAL INC.
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY
FOR THE SIX MONTHS ENDED SEPTEMBER 29, 2006
(In thousands)
(Unaudited)

	Common Stock Shares	Amount	Additional Paid-In Capital	Retained (Deficit) Earnings	Accumulated Other Comprehensive Loss	Total
Balance at March 31, 2006	32,000	$ 320	$ 102,097	$ 4,139	$ (218)	$ 106,338
Comprehensive income:						
Net loss				(3,497)		(3,497)
Interest rate cap					2	2
Currency translation adjustment					(42)	(42)
Comprehensive loss				(3,497)	(40)	(3,537)
Equity offering, net	25,000	250	343,125			343,375
Mandatory dividend on Class B common stock			(95,861)	(4,139)		(100,000)
Deferred compensation expense on Class B equity of DIV Holding LLC			999			999
Balance at September 29, 2006	57,000	$ 570	$ 350,360	$ (3,497)	$ (258)	$ 347,175

See notes to condensed consolidated financial statements.

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

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

Description of Business and Organization

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

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

Equity Offering

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

Basis of Presentation

The condensed consolidated financial statements include the accounts of the Company and its domestic and foreign subsidiaries. These condensed consolidated financial statements have been prepared by the Company, without audit, pursuant to U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. However, the Company believes that all disclosures are adequate to make the information presented not misleading.

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

These condensed consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements and the related notes thereto included in the Company s Annual Report (File No. 001-0824791) on Form 10-K, filed with the Securities and Exchange Commission (the SEC) on June 29, 2006.

In the opinion of management, all adjustments necessary to fairly present the Company s financial position at September 29, 2006 and March 31, 2006, the results of operations for the three and six months ended September 29, 2006 and September 30, 2005, and cash flows for the six months ended September 29, 2006 and September 30, 2005, have been included. The results of operations for the three and six months ended September 29, 2006 are not necessarily indicative of the results to be expected for the full fiscal year or for any future periods. The Company uses estimates and assumptions required for preparation of the financial statements. The estimates are primarily based on historical experience and business knowledge and are revised as circumstances change. However, actual results could differ from the estimates.

The Company reports its results on a 52/53 week fiscal year with the fiscal year ending on the Friday closest to March 31. The three months ended September 29, 2006 was a 13-week period from July 1, 2006 to September 29, 2006. The three months ended September 30, 2005 was a 13-week period from July 2, 2005 to September 30, 2005. The six months ended September 29, 2006 was a 26-week period from April 1, 2006 to September 29, 2006. The six months ended September 30, 2005 was a 26-week period from April 2, 2005 to September 30, 2005.

Principles of Consolidation

All intercompany transactions and balances have been eliminated in consolidation. Investments in which the Company owns a 20% to 50% ownership interest are accounted for by the equity method. These investments are in business entities in which the Company does not have control, but has the ability to exercise significant influence over operating and financial policies. The Company has no investments in business entities of less than 20%.

The following table sets forth the Company s ownership in joint ventures and companies that are not consolidated into the Company s financial statements as of September 29, 2006 and are accounted for by the equity method. For all of the entities listed below, the Company has the right to elect half of the board of directors (the Board of Directors) or other management body. Economic rights are indicated by the ownership percentages listed below.

Global Linguist Solutions LLC	51.0 %
Dyn Al-Rushaid Services LLC	50.0 %
DynCorp-Hiberna Ltd.	50.0 %
DynEgypt LLC	50.0 %
DynPuertoRico Corporation	49.9 %
Contingency Response Services LLC	45.0 %
Partnership for Temporary Housing LLC	40.0 %
Babcock DynCorp Limited	40.0 %

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

Recent Accounting Pronouncements

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

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

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

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

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

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

Reclassification

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

Note 2 Receivables

Receivables consists of the following:

	Sept. 29, 2006	March 31, 2006
Billed	$ 173,602	$ 188,458
Unbilled	241,024	248,994
Unbilled related party		495
Other receivables	1,341	2,248
	$ 415,967	$ 440,195

Unbilled receivables consists of costs and fees billable on contract completion or other specified events, the majority of which is expected to be billed and collected within sixty days. Unbilled receivables includes revenue recognized on projects for which the Company has been requested by the customer to begin work under a new contract or extend work under an existing contract, and for which formal contracts or contract modifications have not been executed at the end of the quarter. At September 29, 2006 and March 31, 2006, unbilled receivables included $23,056 and $31,303, respectively, related to this type of unbilled receivables balance. In addition, unbilled receivables includes amounts related to contract retentions that are billed when the Company has negotiated final indirect rates with the U.S. government and, once billed, are subject to audit and approval by outside third parties. Consequently, the timing of collection of retention balances of $1,419 and $10 as of September 29, 2006 and March 31, 2006, respectively, is outside the Company s control. Based on the Company s historical experience, the majority of the retention balance is expected to be collected beyond one year.

Note 3 Other Intangible Assets and Other Assets

A summary of amortizable intangible assets is as follows:

	September 29, 2006			
	Weighted-Average Amortization Period	Gross Carrying Value	Accumulated Amortization	Net
Customer-related intangible assets	8.5	$ 290,381	$ (63,267)	$ 227,114
Deferred financing cost	7.0	20,272	(4,616)	15,656
Other	4.1	12,510	(5,571)	6,939
		$ 323,163	$ (73,454)	$ 249,709

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