

UNITED DEFENSE INDUSTRIES INC

Form 10-Q

August 05, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2003

**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: 001-16821

UNITED DEFENSE INDUSTRIES, INC.

(Exact Name of Registrant as Specified in its charter)

Delaware
(State or other jurisdiction of incorporation)

52-2059782
(IRS Employer Identification No.)

1525 Wilson Boulevard, Suite 700
Arlington, Virginia
(Address of Principal Executive Offices)

22209
(Zip Code)

(703) 312-6100
(Registrant's telephone number, including area code)

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

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

At July 18, 2003, there were 51,962,221 shares outstanding of the Registrant's common stock, par value \$.01 per share.

UNITED DEFENSE INDUSTRIES, INC.

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UNITED DEFENSE INDUSTRIES, INC.

CONSOLIDATED BALANCE SHEETS
(In thousands)

| | December 31, 2002 | June 30, 2003 |
|--|-------------------|---------------|
| | | (Unaudited) |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 106,802 | \$ 187,856 |
| Trade receivables, net | 192,166 | 189,403 |
| Long-term contract inventories | 399,189 | 337,010 |
| Deferred tax asset | 25,436 | |
| Other current assets | 15,458 | 24,954 |
| | <hr/> | <hr/> |
| Total current assets | 739,051 | 739,223 |
| Property, plant and equipment, net | 170,378 | 178,133 |
| Goodwill, net | 341,962 | 341,962 |
| Intangible assets, net | 32,624 | 26,058 |
| Prepaid pension and postretirement benefit cost | 120,987 | 123,137 |
| Restricted cash | 10,120 | 10,991 |
| Other assets | 38,848 | 28,128 |
| | <hr/> | <hr/> |
| Total assets | \$ 1,453,970 | \$ 1,447,632 |
| | <hr/> | <hr/> |
| LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT) | | |
| Current liabilities: | | |
| Current portion of long-term debt | \$ 13,011 | \$ 39,032 |
| Accounts payable, trade and other | 121,801 | 94,187 |
| Advanced payments | 491,217 | 439,222 |
| Accrued and other liabilities | 139,954 | 118,197 |
| | <hr/> | <hr/> |
| Total current liabilities | 765,983 | 690,638 |
| Long-term liabilities: | | |
| Long-term debt, net of current portion | 576,989 | 550,968 |
| Accrued pension and postretirement benefit cost | 51,964 | 56,447 |
| Deferred tax liability | 15,124 | 19,968 |
| Other liabilities | 73,615 | 83,213 |
| | <hr/> | <hr/> |
| Total liabilities | 1,483,675 | 1,401,234 |
| Commitments and contingencies | | |
| Stockholders' equity (deficit): | | |
| Common stock \$.01 par value, 150,000,000 shares authorized; 51,695,109 and 51,945,221 issued and outstanding at December 31, 2002 and June 30, 2003, respectively | 517 | 519 |
| Additional paid-in-capital | 177,740 | 179,330 |
| Deferred compensation | (547) | (507) |
| Retained deficit | (194,952) | (120,497) |
| Accumulated other comprehensive loss | (12,463) | (12,447) |
| | <hr/> | <hr/> |
| Total stockholders' equity (deficit) | (29,705) | 46,398 |
| | <hr/> | <hr/> |
| Total liabilities and stockholders' equity (deficit) | \$ 1,453,970 | \$ 1,447,632 |
| | <hr/> | <hr/> |

See accompanying notes.

UNITED DEFENSE INDUSTRIES, INC.

UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except shares and per share data)

| | Three months ended June 30, | | Six months ended June 30, | |
|--|-----------------------------|-------------------|---------------------------|-------------------|
| | 2002 | 2003 | 2002 | 2003 |
| Revenue: | | | | |
| Sales | \$ 318,038 | \$ 553,453 | \$ 674,481 | \$ 1,019,976 |
| Costs and expenses: | | | | |
| Cost of sales | 248,102 | 447,180 | 544,696 | 809,763 |
| Selling, general and administrative expenses | 32,368 | 41,868 | 60,485 | 78,938 |
| Research and development | 9,550 | 4,155 | 15,214 | 6,035 |
| | <u>290,020</u> | <u>493,203</u> | <u>620,395</u> | <u>894,736</u> |
| Total expenses | | | | |
| Income from operations | 28,018 | 60,250 | 54,086 | 125,240 |
| Other income (expense): | | | | |
| Earnings (loss) related to investments in foreign affiliates | 6,309 | 6,106 | 7,213 | 11,655 |
| Interest income | 979 | 983 | 2,158 | 1,897 |
| Interest expense | (6,252) | (7,213) | (12,635) | (14,701) |
| | <u>1,036</u> | <u>(124)</u> | <u>(3,264)</u> | <u>(1,149)</u> |
| Total other income (expense) | | | | |
| Income before income taxes | 29,054 | 60,126 | 50,822 | 124,091 |
| Provision for income taxes | 1,757 | 24,050 | 4,507 | 49,636 |
| | <u>27,297</u> | <u>36,076</u> | <u>46,315</u> | <u>74,455</u> |
| Net income | | | | |
| Earnings per common share-basic | \$ 0.53 | \$ 0.70 | \$ 0.90 | \$ 1.44 |
| | <u>51,196,184</u> | <u>51,887,761</u> | <u>51,097,051</u> | <u>51,809,472</u> |
| Weighted average common shares outstanding | | | | |
| Earnings per common share-diluted | \$ 0.52 | \$ 0.68 | \$ 0.87 | \$ 1.41 |
| | <u>52,710,059</u> | <u>52,783,806</u> | <u>52,676,701</u> | <u>52,696,743</u> |
| Weighted average common shares outstanding | | | | |

See accompanying notes.

UNITED DEFENSE INDUSTRIES, INC.

**UNAUDITED CONSOLIDATED STATEMENTS
OF CHANGES IN STOCKHOLDERS' EQUITY (DEFICIT)**
(In thousands)

| | Common Stock | Addition Paid-In Capital | Deferred Compensation | Retained Deficit | Accumulated Other Comprehensive (Loss)/Gain | Total |
|--|-------------------------|---|----------------------------------|-----------------------------|--|------------------|
| Balance, December 31, | \$ 517 | \$ 177,740 | \$ (547) | \$ (194,952) | \$ (12,463) | \$ (29,705) |
| Amortization of deferred stock compensation | | | 40 | | | 40 |
| Exercise of stock options | 2 | 1,590 | | | | 1,592 |
| Net foreign currency translation | | | | | 1,323 | 1,323 |
| Change in fair value of foreign and interest rate hedges, net of tax | | | | | (1,307) | (1,307) |
| Net income for the six months ended June 30, 2003 | | | | 74,455 | | 74,455 |
| Total comprehensive income | | | | | | 74,471 |
| Balance, June 30, 2003 | \$ 519 | \$ 179,330 | \$ (507) | \$ (120,497) | \$ (12,447) | \$ 46,398 |

See accompanying notes.

UNITED DEFENSE INDUSTRIES, INC.

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

| | Six months ended June 30, 2002 | Six months ended June 30, 2003 |
|---|-----------------------------------|-----------------------------------|
| Operating activities | | |
| Net income | \$ 46,315 | \$ 74,455 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Depreciation | 10,266 | 13,410 |
| Amortization of software | 2,802 | 2,415 |
| Amortization of other intangibles | 2,352 | 6,595 |
| Amortization of financing costs | 1,349 | 1,549 |
| Net loss from early extinguishment of debt | 242 | |
| Deferred tax provision (benefit) | | 30,280 |
| Changes in assets and liabilities: | | |
| Trade receivables | (16,576) | 4,713 |
| Inventories | (75,065) | 63,480 |
| Other assets | (19,065) | (777) |
| Prepaid pension and postretirement benefit cost | (1,288) | (2,150) |
| Accounts payable, trade and other | 12,139 | (30,501) |
| Advanced payments | 94,853 | (54,933) |
| Accrued and other liabilities | (9,369) | (13,091) |
| Accrued pension and postretirement benefit cost | (3,933) | 3,355 |
| Cash provided by operating activities | <u>45,022</u> | <u>98,800</u> |
| Investing activities | | |
| Capital expenditures | (7,484) | (23,762) |
| Purchase of Cell ITS, net of \$0.2 million cash acquired | (4,135) | |
| Cash used in investing activities | <u>(11,619)</u> | <u>(23,762)</u> |
| Financing activities | | |
| Payments on long-term debt | (8,306) | |
| Proceeds from sale of common stock | 2,164 | 1,592 |
| Cash (used in) provided by financing activities | <u>(6,142)</u> | <u>1,592</u> |
| Effect of exchange rate changes on cash | <u>6,753</u> | <u>4,424</u> |
| Increase in cash and cash equivalents | 34,014 | 81,054 |
| Cash and cash equivalents, beginning of year | 90,535 | 106,802 |
| Cash and cash equivalents, end of period | <u>\$ 124,549</u> | <u>\$ 187,856</u> |

See accompanying notes.

UNITED DEFENSE INDUSTRIES, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2003**1. Basis of Presentation**

The financial information presented as of any date other than December 31 has been prepared from the books and records without audit. Financial information as of December 31, 2002 presented in this quarterly report has been derived from the audited financial statements of United Defense Industries, Inc., but does not include all the associated disclosures required by generally accepted accounting principles. In the opinion of management, the accompanying unaudited interim financial statements contain all adjustments (consisting of normal, recurring adjustments) necessary to present fairly our financial position as of June 30, 2003 and the results of operations for the three months and six months ended June 30, 2003 and cash flows for the six months ended June 30, 2002 and 2003. The results of operations are not necessarily indicative of the results that may be expected for the year ending December 31, 2003. These unaudited consolidated financial statements should be read in conjunction with the financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2002 and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2003.

2. Summary of Significant Accounting Principles*Stock-Based Compensation*

At June 30, 2003, we had a stock-based employee compensation plan, which is described more fully in our Form 10-K for the year ended December 31, 2002. We account for the plan under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Accordingly, we record compensation expense over the vesting period in our consolidated statements of operations if the option price is less than fair value of the common stock at the date an option is granted. The compensation expense recorded in the financial statements reflects the amortization based on vesting of stock options. The following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation.

| | Three months ended June 30, | | Six months ended June 30, | |
|---|--------------------------------|-----------|------------------------------|-----------|
| | 2002 | 2003 | 2002 | 2003 |
| (In thousands, except per share data) | | | | |
| Net income, as reported | \$ 27,297 | \$ 36,076 | \$ 46,315 | \$ 74,455 |
| Add back: Compensation expense recorded, net of related tax effects | 15 | 12 | 30 | 24 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (220) | (1,049) | (440) | (2,098) |
| Pro forma net income | \$ 27,092 | \$ 35,039 | \$ 45,905 | \$ 72,381 |
| Earnings per share: | | | | |
| Basic as reported | \$ 0.53 | \$ 0.70 | \$ 0.90 | \$ 1.44 |
| Basic pro forma | \$ 0.53 | \$ 0.68 | \$ 0.90 | \$ 1.40 |
| Diluted as reported | \$ 0.52 | \$ 0.68 | \$ 0.87 | \$ 1.41 |
| Diluted pro forma | \$ 0.51 | \$ 0.66 | \$ 0.87 | \$ 1.37 |

UNITED DEFENSE INDUSTRIES, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The effect of applying Statement No. 123 on the net income as stated above is not necessarily representative of the effects on reported net income (loss) for future periods due to, among other things, the vesting period of the stock options and additional stock options that may be granted in the future.

In January 2003, we granted new stock options to purchase 2,200,500 common shares that vest over three years at an exercise price of \$23.15, which resulted in no additional compensation expense. There were no options granted in 2002.

New Accounting Pronouncements

In April 2002, the FASB issued Statement No. 145 (FAS 145), *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*. FAS 145 which became effective January 31, 2003 rescinds Statement 4, which required all gains and losses from extinguishment of debt to be aggregated and, if material, classified as an extraordinary item, net of the related income tax effect. As a result, the criteria in APB 30, *Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, now will be used to classify those gains and losses. Under APB 30, gains and losses on early extinguishment of debt would only be classified as extraordinary if the extinguishment is considered unusual and infrequent.

For the six months ended June 30, 2002 the loss on extinguishment of debt of \$242,000 that was previously reported as an extraordinary item was reclassified to income before extraordinary item (interest expense).

On January 17, 2003 the FASB issued FASB Interpretation No. 46 (FIN 46), *Consolidation of Variable Interest Entities*. FIN 46 becomes effective this year and requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. In general, a variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights, or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. We are in the process of evaluating the impact of the adoption of this Interpretation but do not believe it will have a significant impact on our financial statements.

3. Investments in Affiliated Companies

Our investment in our 51% owned foreign joint venture in Turkey, FNSS Savunma Sistemleri A.S. is accounted for using the equity method because we do not control it due to our partner's veto rights over most operating decisions. We have the ability to exercise influence over its operating and financial policies. In addition, we had a 51% interest in a joint venture in Saudi Arabia, United Defense Systems (UDS) which we also accounted for using the equity method for the same reason. Our share of the earnings related to our investments was \$6.3 million and \$6.1 million for the three months ended June 30, 2002 and 2003 and \$7.2 million and \$11.6 million for the six months ended June 30, 2002 and 2003, respectively. In view of the declining scale and prospects of UDS, we entered into an agreement in March 2002 with our Saudi Arabian joint venture partner to sell our 51% interest. The sale was finalized in March 2003 for \$405,000 and did not result to a significant gain or loss. Beginning in March 1, 2002 we discontinued recording our share of earnings from this joint venture because, under the terms of the sale agreement, we were no longer entitled to such earnings as of that date.

UNITED DEFENSE INDUSTRIES, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table, which summarizes financial information for these joint ventures, reports results from the joint venture in Turkey for the three months and six months ended June 30 of each year and Saudi Arabia only through February of 2002.

| | Three months ended June 30, | | Six months ended June 30, | |
|---------------|--------------------------------|----------|------------------------------|-----------|
| | 2002 | 2003 | 2002 | 2003 |
| | (In thousands) | | | |
| Sales | \$40,922 | \$77,879 | \$67,802 | \$119,732 |
| Cost of Sales | 20,129 | 36,910 | 35,041 | 57,290 |
| Net Income | 12,370 | 11,082 | 16,794 | 20,340 |

4. Comprehensive Income

Comprehensive income was \$54.1 million and \$74.5 million for the six month periods ended June 30, 2002 and 2003, respectively. Comprehensive income consists primarily of net income (\$74.5 million for the six month period ended June 30, 2003), net foreign currency translation adjustments and fair value adjustments of foreign currency and interest rate hedges, net of taxes.

5. Long-term Debt

In August 2001, we entered into a credit facility with various banks that included \$600 million of term loan facilities and a \$200 million revolving credit facility. On July 2, 2002 we amended the credit facility to borrow an additional \$300 million for the purchase of United States Marine Repair, Inc. (USMR).

Outstanding borrowings on the term loan facilities were \$590 million at June 30, 2003. The facilities bear interest at variable rates with a weighted average rate of 3.12% at June 30, 2003. These loans are due through 2009 and provide for quarterly principal and interest payments. No principal payments were due in the first half of 2003 due to early repayments.

6. Pension and Other Post Retirement Benefits

At December 31, 2002, we revised the discount rate assumption used in the determination of net pension and post retirement costs and benefit obligations from 7% to 6.5%. On January 1, 2003 we revised the rate of return assumption used for the actuarial estimates of these benefit programs from 9% to 8.5%. The impact of these two changes is estimated to result in an increase in pension and post-retirement benefit costs for the full year 2003 of approximately \$7.0 million compared with what the estimated 2003 expense would have been if the changes in assumptions had not been made.

7. Commitments and Contingencies

Termination Claims

The Crusader program commenced in 1994 to develop for the U.S. Army an integrated and extensively automated two-vehicle artillery system consisting of a 155mm, self-propelled howitzer and a resupply vehicle. Since inception of the program, we have been the sole-source prime contractor for its design and development. The Army's plan called for fielding of 480 Crusader systems, but in May 2002 the Secretary of Defense announced the termination of the program. The Army gave us formal notice of termination on August 7, 2002, and we have subsequently received Army funding to accomplish an orderly closeout of Crusader activities and to transition key Crusader technologies to the NLOS-C program. To date, the Crusader termination has resulted in a reduction to our workforce of approximately 180 employees. Through the period ended June 30, 2003, we have invoiced the U.S. Government for \$36.3 million of termination costs and fees, the majority of which was collected in 2002 and the balance received in first half of 2003. In order to complete the Crusader

UNITED DEFENSE INDUSTRIES, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

termination process, we will need to negotiate a final settlement with the Army, and expect to submit our settlement proposal in August 2003.

Legal Proceedings

As a government contractor, we are subject to the audit, review, and investigative authority of various U.S. Government agencies. Depending upon the particular jurisdictional statute, violations of federal procurement rules may result in contract price reductions or refunds, civil penalties, and/or criminal penalties. Government contractors that violate the False Claims Act and/or other applicable laws may be suspended or debarred from receiving further government contracts. Given our dependence on U.S. Government contracts, suspension or debarment is an inherent risk that could readily have a material adverse effect on us. Our policy is to cooperate with governmental investigations and inquiries regarding compliance matters, and we also make voluntary disclosures of compliance issues to governmental agencies as appropriate. In the ordinary course of business, we provide information on compliance matters to various government agencies, and we expect to continue to do so in the future. For example, as previously disclosed, on August 8, 2002 we were served with a grand jury subpoena issued by the United States District Court for the Eastern District of Virginia, seeking information regarding a 2000 contract between us and the Italian government for the upgrading of amphibious assault vehicles. We believe that the grand jury investigation seeks to ascertain whether any violation of the Foreign Corrupt Practices Act occurred in connection with the Italian contract. While management is not aware of any such violation, and we are cooperating with the investigation, it is too early for us to determine whether the ultimate outcome of the investigation would have a material adverse impact on our results of operation or financial position.

From time to time we are involved in legal proceedings arising in the ordinary course of our business. We believe that we have adequately reserved for these liabilities and that there is no litigation pending that could have a material adverse effect on our results of operations and financial condition.

Environmental Matters

We spend certain amounts annually to comply with environmental laws. Operating and maintenance costs associated with environmental compliance and prevention of pollution at our facilities are a normal, recurring part of operations, are not significant relative to total operating costs or cash flows, and are generally allowable as contract costs under our contracts with the U.S. Government (Allowable Costs).

As with compliance costs, a significant portion of our expenditures for remediation of existing contamination at our facilities consists of Allowable Costs. As of June 30, 2003, we had accrued approximately \$31.4 million to cover any investigation and/or remediation costs that may not be Allowable Costs under U.S. Government contracts. The amount accrued is based on reasonable estimates, although there is a possibility that costs in excess of such accruals may be incurred. The amount accrued is stated on an undiscounted basis. The most significant of our estimated liabilities pertain to ongoing remediation efforts.

Pursuant to a demand from the California Regional Water Quality Control Board, we are completing a study of sedimentary contamination in San Diego Bay for the purpose of establishing clean-up criteria for future remediation work. Once definitive clean-up criteria are established, we expect that we will be required to begin remediation procedures with respect to the contamination. We anticipate that the total costs associated with the remediation phase will range from \$6 million to \$9 million, of which \$8.5 million has been accrued, although it is conceivable that costs could be as high as \$40 million if the most stringent clean-up standard were to be adopted. Approximately \$8.9 million of such remediation cost, to the extent the costs are not recovered on USMR's government contracts or from other responsible parties, may be recoverable from USMR's former shareholders, under an escrow arrangement established in 1997 when the San Diego operation was acquired by USMR. An additional \$15 million escrow fund was established in our 2002 acquisition of USMR, which may be available in respect of USMR's sediment exposure.

UNITED DEFENSE INDUSTRIES, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Pursuant to the terms of the 1997 acquisition of United Defense, L.P., FMC Corporation and Harsco Corporation (collectively, the Sellers) are required to reimburse us for 75% of certain remediation costs that are Non-Allowable Costs through October 6, 2007 for environmental losses we have previously identified to the Sellers. Accordingly, we have recorded a receivable for \$1.5 million for which we expect to be reimbursed by the Sellers over approximately the next 5 years under the terms of the 1997 acquisition agreement.

Since approximately 1941, we (and, prior to our formation, Northern Ordnance, Inc. and then FMC) have operated the Fridley, Minnesota facility. The majority of the Fridley facility is owned by the U.S. Navy (the Navy property), but has been operated by us under a contract with and on behalf of the Navy. We own the remainder of the facility. Since 1991, the Navy has expended approximately \$27 million in remediation costs, including site investigation, on the Navy property, and the Navy has indicated that it anticipates spending a further \$8.9 million on such matters at the site. The Navy has engaged us in discussions as to whether we should pay a portion of such expenses, and offered to resolve the matter if we would pay 25% of such costs (approximately \$8.4 million). We dispute any responsibility for such costs, and also believe that any environmental costs that we may incur at Fridley would constitute Allowable Costs. However, there is substantial uncertainty regarding the ultimate terms on which the matter might be resolved (whether by settlement, legal proceedings, or otherwise).

8. United States Marine Repair Acquisition

Effective July 2, 2002, we completed the acquisition of 100% of the outstanding stock of USMR from The Carlyle Group for \$305.4 million (net of \$7.3 million of acquired cash), including the repayment of approximately \$105 million of USMR debt. We incurred an additional \$1.5 million of transaction costs related to the acquisition. The acquisition of USMR balances and diversifies our portfolio, gives us a strategic growth platform and expands our mission to support the U.S. Navy with superior technology and services. As a result of the transaction, USMR is now a wholly owned subsidiary. The transaction was accounted for as a purchase. We financed the acquisition with cash on hand and by amending our credit facility to borrow an additional \$300 million. We began to consolidate the results of operations of USMR as of the effective date of the acquisition.

The following are our unaudited pro forma consolidated results of operations, assuming the USMR acquisition occurred at the beginning of each period presented.

| | Three months ended June 30, | | Six months ended June 30, | |
|---------------------------------------|--------------------------------|-----------|------------------------------|-------------|
| | 2002 | 2003 | 2002 | 2003 |
| (in thousands, except per share data) | | | | |
| Sales | \$451,490 | \$553,453 | \$925,724 | \$1,019,976 |
| Cost of Sales | 364,728 | 447,180 | 760,346 | 809,763 |
| Net Income | 27,553 | 36,076 | 49,067 | 74,455 |
| Earnings per common share basic | \$ 0.54 | \$ 0.70 | \$ 0.97 | \$ 1.44 |
| Earnings per common share diluted | \$ 0.52 | \$ 0.68 | \$ 0.94 | \$ 1.41 |

These unaudited proforma consolidated results are not necessarily indicative of future outcomes.

Goodwill of \$240.3 million resulting from the USMR acquisition was assigned to the Ship Repair and Maintenance segment.

9. Earnings Per Share

Basic and diluted earnings per share results for all periods presented were computed based on the net income for the respective periods. The weighted average number of common shares outstanding during the period was used in the calculation of basic earnings per share and this number of shares was increased by the

UNITED DEFENSE INDUSTRIES, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

effects of dilutive stock options based on the treasury stock method in the calculation of diluted earnings per share.

New stock options to purchase 2,200,500 common shares granted in January 2003 were included in the computation of diluted earnings per share.

| | Three months ended June 30, | | Six months ended June 30, | |
|--|--------------------------------|-----------|------------------------------|-----------|
| | 2002 | 2003 | 2002 | 2003 |
| (In thousands, except per share data) | | | | |
| Net income | \$ 27,297 | \$ 36,076 | \$ 46,315 | \$ 74,455 |
| Average common shares outstanding: | | | | |
| Average common shares outstanding for basic computations | 51,196 | 51,888 | 51,097 | 51,809 |
| Dilutive stock options-based on the treasury stock method | 1,514 | 896 | 1,580 | 888 |
| Average number of common shares outstanding for diluted computations | 52,710 | 52,784 | 52,677 | 52,697 |
| Earnings per share: | | | | |
| Earnings per share basic | \$ 0.53 | \$ 0.70 | \$ 0.90 | \$ 1.44 |
| Earnings per share diluted | \$ 0.52 | \$ 0.68 | \$ 0.87 | \$ 1.41 |

10. Information on Business Segments

We operate in two business segments: Defense Systems and Ship Repair and Maintenance. USMR is categorized under the business segment Ship Repair and Maintenance. All other business operations are categorized as Defense Systems. We use income before interest and taxes as the measure of financial performance for each segment as it equates to the operational performance of the segment.

Summary financial data for each of our business segments for three month and six month periods ended June 30, 2002 and 2003 follow:

| | Three months ended June 30, | | Six months ended June 30, | |
|-----------------------------|--------------------------------|------------|------------------------------|------------|
| | 2002 | 2003 | 2002 | 2003 |
| (in thousands) | | | | |
| Sales: | | | | |
| Defense Systems | \$ 318,038 | \$ 435,421 | \$ 674,481 | \$ 776,004 |
| Ship Repair and Maintenance | | 118,032 | | 243,972 |
| Total sales | 318,038 | 553,453 | 674,481 | 1,019,976 |

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| | | | | |
|--|-------------------|-------------------|-------------------|-------------------|
| Income before interest and taxes: | | | | |
| Defense Systems | 39,316 | 62,804 | 69,577 | 129,770 |
| Ship Repair and Maintenance | | 9,155 | | 16,525 |
| Corporate | (4,989) | (5,603) | (8,278) | (9,400) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total income before interest and taxes | 34,327 | 66,356 | 61,299 | 136,895 |
| Interest, net | (5,273) | (6,230) | (10,477) | (12,804) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Income before income taxes | \$ 29,054 | \$ 60,126 | \$ 50,822 | \$ 124,091 |

UNITED DEFENSE INDUSTRIES, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

| | December 31, 2002 | June 30, 2003 |
|-----------------------------|----------------------|------------------|
| Total assets: (a) | | |
| Defense Systems | \$ 884,261 | \$ 811,379 |
| Ship Repair and Maintenance | 421,300 | 422,744 |
| Corporate and eliminations | 148,409 | 213,509 |
| Total assets | \$1,453,970 | \$1,447,632 |

- (a) Goodwill and other intangible assets and related amortization, and net pension and other post retirement benefits are included in the respective business segments. Corporate assets primarily include cash and cash equivalents, deferred financing costs and deferred taxes.

11. Income Taxes

We account for income taxes under the liability method. Under this method, deferred tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws expected to be effective when these differences reverse.

The provision for income taxes for the three and six month periods ended June 30, 2003, was \$24.1 million and \$49.6 million, respectively, which increased by \$22.3 million and \$45.1 million, respectively, from the same periods in 2002 primarily due to higher taxable income and to the utilization of net operating loss carryforwards in 2002 to substantially offset income tax expense. The provision for income taxes in 2003 more closely reflects underlying statutory tax rates as a result of the reversal of the valuation allowance against net operating loss carryforwards and other deferred tax assets in 2002.

12. Related Party Transactions

Investment funds sponsored by The Carlyle Group (Carlyle) continue to own a significant portion of our common shares. Individuals affiliated with Carlyle are expected to continue to influence our operations. We have entered into agreements with four affiliates of our principal stockholders whereby we have agreed to designate one nominee to our board of directors on behalf of each of these entities. These agreements provide for such board representation so long as Carlyle owns greater than 20% of our voting stock. However, in conjunction with Carlyle's pending sale of 10,800,000 shares of our stock (which would reduce Carlyle's ownership in United Defense from 46.75% to 25.96%), we expect Carlyle's representation on our board to decline proportionately in the months ahead.

In accordance with the management agreement between United Defense Industries and Carlyle, we accrued a fee of \$1 million for various management services provided by Carlyle for the six months ended June 30, 2003.

We have entered into an agreement with CPU Technology, Inc. (CPU/T) to purchase approximately \$1.4 million in component and design services regarding electronic subsystems for the Bradley program. Certain Carlyle affiliates are minority stockholders of CPU/T and collectively have the right to appoint two of the six members of CPU/T's board.

We recognized \$2.7 million and \$9.1 million of royalties, license fees and technical service fees during the six month periods ended June 30, 2002 and 2003, respectively, from our Turkish joint venture. We have also entered into an agreement with our Turkish joint venture to purchase approximately \$2.4 million in miscellaneous parts and kits for our M113 vehicles and Mk25 canisters.

UNITED DEFENSE INDUSTRIES, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Item 2. Management's Discussion and Analysis of the Results of Operations and Financial Condition June 30, 2003
Special Note Regarding Forward Looking Statements

Our Form 10-Q disclosure and analysis concerning our operations, cash flows and financial position, including, in particular, the likelihood of our success in developing and expanding our business and the realization of sales from our backlog, include forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Statements that are predictive in nature, that depend upon or refer to future events or conditions, or that include words such as expects, anticipates, intends, plans, believes, estimates, similar expressions are forward-looking statements. Although these statements are based upon assumptions we consider reasonable, they are subject to risks and uncertainties that are described more fully below and in our annual report on Form 10-K for the year ended December 31, 2002, our quarterly report on Form 10-Q for the three months ended March 31, 2003 and our Prospectus Supplement dated July 31, 2003. Accordingly, we can give no assurance that we will achieve the results anticipated or implied by our forward-looking statements.

Overview

United Defense is a leader in the design, development and production of combat vehicles, artillery systems, naval guns, missile launchers and precision munitions used by the U.S. Department of Defense (DoD) and more than 40 foreign militaries, and is the leading U.S. provider of non-nuclear ship repair, modernization and conversion services to the U.S. Navy and related government agencies. For many of our key DoD programs, we are the sole-source prime contractor and systems integrator. We conduct global operations through our manufacturing facilities in the United States and Sweden, our ship repair facilities in Virginia, California, Hawaii, Florida and Texas, a manufacturing joint venture in Turkey, and co-production programs with various other governments and foreign contractors.

The Carlyle Group formed United Defense Industries, Inc. in October 1997 to facilitate the acquisition of United Defense, L.P., our predecessor entity. The Carlyle Group continues to own a significant portion of our common stock. In July 2002 we acquired United States Marine Repair (USMR) from The Carlyle Group.

Our results of operations, particularly revenue, gross profits and cash flows, vary significantly from period to period depending largely upon the timing of our delivery of finished products, the terms of our contracts and our level of export sales. As a result, period-to-period comparisons may show substantial changes disproportionate to our underlying business activity. Period to period comparisons are also affected by acquisitions where the results of operations for the acquired business are included in our results only for periods subsequent to the date of acquisition. This is the case for the July 2002 acquisition of USMR.

Our contracts typically fall into two categories, cost-plus and fixed-price. Our contracts for research, engineering, prototypes, and some other matters are typically cost-plus arrangements under which we are reimbursed for approved costs and also receive a fee. Our production contracts are typically fixed-price arrangements under which we assume the risk of cost overruns and receive the benefit of cost savings. Our repair and maintenance contracts are a mix of fixed-price and cost-plus arrangements with a recent trend toward cost-plus. All of our DoD contracts, whether we are the prime contractor or a subcontractor, are subject to audit and cost controls. As a result, the DoD typically has the right to object to our costs as not allowable or as unreasonable, which can increase the costs we bear rather than allow recovery as costs reimbursed or allowed in our negotiation of fixed-price contracts.

We use different techniques for estimating and recording revenues depending on the type and characteristics of the contract. Sales are recognized on most fixed-price production contracts when the risks and rewards of ownership have been transferred to the customer. For our DoD production contracts, those criteria are typically met when the manufacture of the product is completed and the customer has certified it as meeting the contract specifications and as having passed quality control tests. For our foreign production contracts, sales are generally recorded upon shipment of products to the customer, which corresponds to when the risks and rewards of ownership transfer. Gross margin on each unit delivered or accepted is recognized

based on an estimate of the margin that will be realized over the life of the related contract. We evaluate estimates of gross margin on production contracts and recognize changes in estimates of gross margins during the period in which those changes are determined. Sales under fixed-price ship repair and maintenance contracts are recognized using the percentage of completion method. Under this percentage of completion method, contract costs are expensed as incurred and sales are recognized simultaneously based on the ratio of direct labor inputs and other costs incurred to date compared to estimated total direct labor inputs and total costs. Sales under cost reimbursement contracts for research, engineering, prototypes, ship repair and maintenance and certain other contracts are recorded as costs are incurred and include estimated fees in the proportion that costs incurred to date bear to total estimated costs. We charge any anticipated losses on a contract to operations as soon as those losses are determined.

We are a supplier of armored combat vehicles and weapons delivery systems to the DoD and a number of allied military forces worldwide. Our products include critical elements of the U.S. military's tactical force structure. We had a firm funded backlog of approximately \$2.2 billion as of June 30, 2003, a substantial majority of which was derived from sole-source, prime contracts. Approximately 76% of our sales for the six months ended June 30, 2003 were to the U.S. government, primarily to agencies of the DoD (excluding Foreign Military Sales), or through subcontracts with other government contractors.

There were no material changes to our major programs from those described in our Form 10-K Report for the year ended December 31, 2002, other than normal additional funding as new contracts are negotiated and awarded.

Business Segments, Products and Programs

We operate in two business segments: Defense Systems and Ship Repair and Maintenance. Our Defense Systems program portfolio consists of a mix of weapons systems development, production, upgrade and life cycle support programs. Our Ship Repair and Maintenance business segment consists of ship repair, maintenance, and modernization service programs. Revenue generated from each of our major programs is summarized below.

| | Three months ended June 30, | | Six months ended June 30, | |
|---|--------------------------------|----------|------------------------------|-----------|
| | 2002 | 2003 | 2002 | 2003 |
| (In millions) | | | | |
| Defense Systems: | | | | |
| Bradley Family of Vehicles | \$ 65.1 | \$ 121.0 | \$ 141.0 | \$ 210.8 |
| Naval Ordnance | 32.2 | 73.3 | 84.8 | 117.2 |
| Vertical Launch Systems | 27.7 | 27.3 | 58.9 | 49.3 |
| Combat, Engineering & Recovery Vehicles | 36.0 | 26.9 | 65.6 | 66.3 |
| Artillery Systems (a) | 79.8 | 68.3 | 166.4 | 120.0 |
| Assault, Amphibious Vehicles | 8.4 | 34.8 | 21.5 | 64.5 |
| Other | 68.8 | 83.8 | 136.3 | 147.9 |
| Total Defense Systems | 318.0 | 435.4 | 674.5 | 776.0 |
| Ship Repair and Maintenance | 0.0 | 118.1 | 0.0 | 244.0 |
| Total | \$318.0 | \$553.5 | \$674.5 | \$1,020.0 |

(a) Includes Crusader, FCS/ NLOS-C, and M109 Howitzer systems

(b) Includes ship repair and maintenance activities at USMR

For a more detailed description of our business and principal operating programs, see our Form 10-K for the year ended December 31, 2002.

Results of Operations

Revenue

Revenue for the three months ended June 30, 2003 of \$553.5 million was \$235.5 million, or 74.1%, higher than revenue of \$318.0 million for the comparable period in 2002. This increase is partially attributable to inclusion of \$118.1 million of revenue in 2003 resulting from the acquisition of USMR on July 2, 2002. The remainder of the revenue increase is attributable to higher sales from continuing programs in the Defense Systems segment. Revenue for the Defense Systems segment was \$435.4 and \$318.0 million in the three month periods ended June 30, 2003 and 2002, respectively, an increase of \$117.4 million, or 36.9%. Bradley sales in the quarter of \$121.0 million were \$55.9 million higher than the same period in 2002 due to the timing of the Army's A3 upgrade fielding schedule. Naval Ordnance sales of \$73.3 million were \$41.1 million higher than the same period in 2002 driven by the ramp up in the DD(X) Advanced Gun System (AGS) development work. Assault Amphibious Vehicle (AAV) sales of \$34.8 million grew by \$26.4 million as we continued to ramp up deliveries to Italy.

Revenue of \$1.02 billion for the six months ended June 30, 2003 was \$345.5 million higher than the \$674.5 million for the same period in 2002, an increase of 51.2%. Sales from our Ship Repair and Maintenance segment which was acquired in July 2002, accounted for \$244.0 million of the increase. Our Defense Systems segment sales were \$776.0 million and \$674.5 million for the six months ended June 30, 2003 and 2002, respectively. The \$101.5 million increased sales in the 2003 period was attributed to higher Bradley and AAV deliveries and a ramp-up in DD(X) AGS development work more than offsetting \$46.4 million in lower Artillery System work due to the cancellation of Crusader in August of 2002.

Gross profit

Gross profit of \$106.3 million in the three month period ended June 30, 2003 was \$36.4 million, or 52% higher than the \$69.9 million for the corresponding period in 2002. This increase was attributable to higher Defense System segment sales and the inclusion of \$17.3 million of USMR gross profit in the 2003 period. Gross profit as a percentage of sales for the three months ended June 30, 2003 was 19.2% compared to 22.0% for the same period in 2002. The major factor influencing the change in gross profit percentage was the acquisition of USMR in July 2002 since that segment has a historically lower gross profit rate than our other programs. The Defense Systems segment's gross profit rate for the three months ended June 30, 2003 and 2002 was 20.4% and 22.0%, respectively. The Ship Repair and Maintenance segment's gross profit rate was 14.7% for the three months ended June 30, 2003.

Gross profit for the six months ended June 30, 2003 was \$210.2 million, \$80.4 million higher than the \$129.8 million in the same prior period. The increase was attributed primarily to higher sales in our Defense Systems segment and the inclusion of \$32.5 million of gross profit from USMR in the 2003 period. Gross profit as a percentage of sales for the six months ended June 30, 2003 was 20.6% compared with 19.2% for the same period last year. Defense System segment's gross profit rate for the six month period ended June 30, 2003 was 22.9% compared with 19.2% for the same period in 2002 when the segment's profit rate was 19.2%. The increase in the 2003 profit rate is due to an \$8.2 million award fee in 2003 for the Crusader program, higher royalty payments from our foreign affiliate in Turkey, and favorable profit adjustments on several production contracts. The Ship Repair and Maintenance segment's gross profit rate was 13.3% for the six months ended June 30, 2003.

Selling, general and administrative expenses

Selling, general and administrative expenses for the three months ended June 30, 2003 were \$41.9 million, or \$9.5 million higher than the \$32.4 million for the same period in 2002. The increase was due primarily to the inclusion of \$8.1 million of United States Marine Repair's general and administrative expenses in 2003 versus no expenses in 2002 since the acquisition was not completed until July of 2002.

Selling, general and administrative expenses for the six months ended June 30, 2003 and 2002 were \$78.9 million and \$60.5 million, respectively. The inclusion of USMR in 2003 results accounted for

\$16.0 million of the \$18.4 million increase. The balance was associated with higher bid and proposal expenses primarily in support of the development of Future Combat Systems (FCS) proposals.

Research and development

Research and development costs were \$4.2 million and \$6.0 million for the three and six month periods ended June 30, 2003, respectively, compared with \$9.6 million and \$15.2 million for the corresponding prior periods. Research and development costs were higher in 2002 as a result of spending on projects in preparation for the Army's FCS program and higher spending on projects related to the AGS and Advanced Vertical Launch System for the Navy's DD(X) destroyer.

Earnings from foreign affiliates

Earnings from foreign affiliates were \$6.1 million for the three months ended June 30, 2003 as compared with \$6.3 million in the same period last year. For the six months ended June 30, 2003, earnings from foreign affiliates of \$11.7 million compared with \$7.2 million earnings for the same prior year period. The higher earnings in 2003 were a result of higher vehicle sales at our Turkish joint venture.

Interest expense

Net interest expense was \$6.2 million in the three months ended June 30, 2003 compared with \$5.3 million for the same period in 2002. For the six months ended June 30, 2003, net interest expense of \$12.8 million was \$2.3 million higher than the same prior period. The higher interest expense in 2003 was due to the increased debt level from the acquisition of USMR offset slightly by the effect of a lower interest rate on our variable rate debt in 2003.

Provision for Income Taxes

The provision for income taxes for the three-month period ended June 30, 2003 was \$24.1 million compared with \$1.8 million for the corresponding 2002 period. For the six months ended June 30, 2003, the provision for income taxes was \$49.6 million compared with \$4.5 million in the same period in 2002. The respective increases of \$22.3 million and \$45.1 million for the three month and six month periods in 2003 were due primarily to utilization of net operating loss carryforwards in 2002 to substantially offset income tax expense. The provision for income taxes in 2003 was based on an estimated annual effective income tax rate and more closely reflects underlying statutory tax rates as a result of the reversal of the valuation allowance against net operating loss carryforwards and other deferred tax assets in 2002.

Net income

As a result of the foregoing factors, we had a net income of \$36.1 million in the three months ended June 30, 2003, compared with \$27.3 million in the same period. For the six months ended June 30, 2003, we had net income of \$74.5 million compared with \$46.3 million for the same period in 2002.

Liquidity, Capital Resources and Financial Condition

Cash provided by operating activities was \$98.8 million for the six month period ended June 30, 2003 compared with \$45.0 million in the same period in 2002, a \$53.8 million increase. The primary reasons for the increase were \$28.2 million in higher net income, and receipt of a \$17.1 million earnings distribution, net of taxes, from our joint venture in Turkey.

Cash used in investing activities was \$23.8 million for the six month period ended June 30, 2003 compared with \$11.6 million in the prior year period. During the second quarter of 2003, capital expenditures included the purchase of a drydock and the expense to install it at our USMR Norfolk, Virginia facility. Expenditures for manufacturing, ship repair, and computer equipment and software primarily represent the balance of capital expenditures. Cash used for investing activities in 2002 included the acquisition of Cell ITS AB for \$4.1 million.

Cash provided by financing activities was \$1.6 million for the six month period ended June 30, 2003, compared with \$6.1 million of cash usage in the same period in 2002. Principal payments on debt in the first half of 2002 was \$8.3 million compared to \$0 in the same period in 2003. There were no scheduled principal payments on our senior credit facility for the six months ended June 30, 2003.

Based on current levels of operations and anticipated growth, we believe that our cash from operations, together with other available sources of liquidity, including borrowings available under the revolving credit facility, will be sufficient to fund anticipated capital expenditures and make required payments of principal and interest on debt, including payments due under our senior credit facility, for the foreseeable future.

U.S. Army Transformation

In our Form 10-K Report for the year ended December 31, 2002, Item 7, Management's Discussion and Analysis, describes recent and potential developments affecting our ground combat vehicle business under the heading, "U.S. Army Transformation". The Army's transformation efforts, including ongoing Stryker procurements and the development of the FCS program, continue to receive attention both because of their overall significance in the Army's evolution and in the context of the 2003 U.S. military experience in Iraq. Such consideration has focused in part on the Administration's budget for the DoD for the fiscal year ending September 30, 2004 (FY04).

The DoD budget tends to have significant implications for the ground combat vehicle portion of our Defense Systems segment, primarily regarding the Bradley, NLOS-C, and FCS programs. While Congressional consideration of the FY04 DoD budget is unlikely to be completed until later this year, the pertinent Congressional deliberations and reports to date suggest that:

- (1) Congress will likely provide at least the \$1.7 billion sought by the Administration for FCS and related activities and will attempt to restrict approximately \$350 million to indirect fire programs. Such funding would tend to benefit both our Non-Line-of-Sight Cannon (NLOS-C) development program and other FCS combat vehicle development activities in which we participate or expect to participate.
- (2) Although the Administration did not propose to acquire additional Bradley A3 vehicle upgrades (i.e., beyond those covered by our current multiyear contract which expires in 2005), Congress will likely provide between \$60 million and \$258 million for additional Bradley upgrades. Since such appropriations cover both the program administration performed by the Army and the vehicle work performed by its contractors, we would ordinarily expect to receive a major portion (typically, 65-75%), rather than all, of such funding.
- (3) Congress will likely provide approximately the \$1 billion sought by the Administration for further procurement of Stryker vehicles. As we participate only minimally in the Stryker program, the net effect of such funding is to place major portion of the Army's combat vehicle procurement spending beyond our reach.

FY04 funding for our Army-related development (such as NLOS-C and FCS) activities would likely result in revenue occurring during 2004 and 2005, and for manufacturing activity (such as the Bradley) in revenue during 2005 and 2006.

Item 3. Quantitative and Qualitative Disclosures About Market Risk June 30, 2003

All of our financial instruments that are sensitive to market risk are entered into for purposes other than trading.

Forward Currency Exchange Risk

We conduct some of our operations outside the U.S. in functional currencies other than the U.S. dollar. To mitigate the risk associated with fluctuating currencies on short-term and long-term foreign currency-denominated transactions, we enter into foreign currency forward exchange contracts. We do not enter into foreign currency forward exchange contracts for trading purposes. The following table provides information with respect to significant contracts at June 30, 2003. The table presents the U.S. dollar equivalent notional amounts and weighted average contractual exchange rates by expected maturity dates. These notional amounts generally are used to calculate the contractual payments to be exchanged under the contract.

| | Expected Maturity Date | | | Total | Fair Value |
|--|------------------------|-----------|-----------|-----------|------------|
| | 2003 | 2004 | 2005-2006 | | |
| (U.S. \$ equivalent in thousands) | | | | | |
| Receive Swedish krona/pay euros | | | | | |
| Contract amount | \$ 3,546 | \$ 3,546 | \$ | \$ 7,092 | \$ 6,879 |
| Average contractual exchange rate | 9.54 | 9.54 | | 9.54 | |
| Receive Swedish krona/pay British pounds | | | | | |
| Contract amount | \$ | \$ | \$ 16,374 | \$ 16,374 | \$ 15,549 |
| Average contractual exchange rate | | | 13.86 | 13.86 | |
| Receive U.S. dollars/pay euros | | | | | |
| Contract amount | \$ | \$ 22,700 | \$ | \$ 22,700 | \$ 27,088 |
| Average contractual exchange rate | | 1.05 | | 1.05 | |

Interest Rate Risk

Borrowings under our senior secured credit facility are sensitive to changes in interest rates. The weighted average interest rate on our borrowings outstanding under the senior secured credit facility as of June 30, 2003 was 3.12%.

In January 2002, we entered into an interest rate protection agreement to mitigate risks associated with variable interest rate borrowings under our senior secured credit facility. The notional amount of this interest rate swap agreement is \$173 million. The agreement entitles us to pay a base interest rate of 3.45%, in return for the right to receive a floating interest rate which is based on three-month LIBOR as of each quarterly measurement date. In the event the three-month LIBOR at the measurement date exceeds 6%, the base interest rate is adjusted to the then effective LIBOR up to a maximum of 8%. USMR had also entered into an interest rate protection agreement to mitigate risks associated with variable interest rate borrowings. The notional amount of the agreement is \$20 million with a maturity date of January 29, 2004. The agreement entitles us to pay base interest rate of 3.77% in return for the right to receive a floating interest rate that is based on three month LIBOR as of each quarterly measurement date. The net cash amounts paid or received on these agreements are accrued and recognized as an adjustment to interest expense.

Item 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only

reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply judgment in evaluating the cost-benefit relationship of possible controls and procedures. Also, we have investments in an unconsolidated entity. As we do not control or manage this entity, our disclosure controls and procedures with respect to this entity are necessarily substantially more limited than those we maintain with respect to our consolidated subsidiaries.

As required by SEC Rule 13a-15(b), an evaluation was performed under the supervision and with the participation of United Defense Industries, Inc. management, including our principal executive officer and our principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based upon that evaluation, our management, including our principal executive officer and our principal financial officer, concluded that the design and operation of these disclosure controls and procedures were effective at the reasonable assurance level.

There has been no change in our internal controls over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

PART II

OTHER INFORMATION

June 30, 2003

Item 4. Submission of Matters to a Vote of Security Holders

We held our annual meeting of stockholders on May 28, 2003. The matters voted upon at the meeting and the corresponding results are set forth below.

1. The election of nine directors to hold office until the next annual meeting of stockholders and until their respective successors have been elected or appointed:

| | <u>For</u> | <u>Withheld</u> |
|-------------------------|------------|-----------------|
| Frank C. Carlucci | 46,943,565 | 2,438,644 |
| Peter J. Clare | 46,864,998 | 2,517,211 |
| William E. Conway, Jr. | 42,297,298 | 7,084,911 |
| C. Thomas Faulders, III | 47,046,223 | 2,335,986 |
| Allan M. Holt | 42,985,023 | 6,397,186 |
| J.H. Binford Peay, III | 42,786,098 | 6,596,111 |
| Thomas W. Rabaut | 46,943,565 | 2,438,644 |
| Francis Raborn | 46,943,565 | 2,438,644 |
| John M. Shalikhshvili | 47,046,223 | 2,335,986 |

2. Stockholder ratification of the appointment of Ernst & Young LLP as independent auditors for the fiscal year ending December 31, 2003:

| <u>For</u> | <u>Against</u> | <u>Abstain</u> | <u>Broker Non-Votes</u> |
|------------|----------------|----------------|-----------------------------|
| 48,734,401 | 640,374 | 7,434 | 0 |

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

31.1 Certification of Chief Executive Officer

31.2 Certification of Chief Financial Officer

32.1 Certification of Chief Executive Officer

32.2 Certification of Chief Financial Officer

(b) Reports on Form 8-K

On April 29, 2003, we filed a report on Form 8-K to include our first quarter 2003 earnings press release.

SIGNATURE

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

By: /s/ FRANCIS RABORN

Francis Raborn
*Principal Financial and Accounting Officer
and Authorized Signatory*

Dated: August 5, 2003