

HALIFAX CORP OF VIRGINIA

Form 10-Q

February 16, 2010

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HALIFAX CORPORATION of VIRGINIA
FORM 10-Q
December 31, 2009

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2009
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 1-08964
Halifax Corporation of Virginia
(Exact name of registrant as specified in its charter)**

Virginia 54-0829246

(State or other jurisdiction of incorporation or organization) (IRS Employer Identification No.)

5250 Cherokee Avenue, Alexandria, VA 22312

(Address of principal executive offices) (Zip code)
(703) 658-2400

(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 has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

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

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. There were 3,175,206 shares of common stock outstanding as of February 16, 2010.

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HALIFAX CORPORATION OF VIRGINIA

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

<i>(Amounts in thousands, except share data)</i>	December 31, 2009	March 31, 2009
ASSETS		
CURRENT ASSETS		
Cash	\$ 183	\$ 484
Restricted cash	4	282
Accounts receivable, net	5,936	6,794
Inventory, net	2,589	2,588
Prepaid expenses and other current assets	428	208
TOTAL CURRENT ASSETS	9,140	10,356
PROPERTY AND EQUIPMENT, net	664	727
GOODWILL	2,918	2,918
OTHER INTANGIBLE ASSETS, net	185	374
OTHER ASSETS	38	56
TOTAL ASSETS	\$ 12,945	\$ 14,431
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 2,268	\$ 2,254
Accrued expenses	1,301	2,292
Deferred maintenance revenues	2,330	2,072
Current portion of long-term debt	186	331
Bank debt	1,715	2,545
Income taxes payable	41	67
TOTAL CURRENT LIABILITIES	7,841	9,561
SUBORDINATED DEBT AFFILIATE	1,000	1,000
OTHER LONG-TERM DEBT	139	141
DEFERRED INCOME		40
TOTAL LIABILITIES	8,980	10,742

COMMITMENTS AND CONTINGENCIES

STOCKHOLDERS EQUITY

Preferred stock, no par value Authorized 1,500,000, none issued or outstanding

Common stock, \$.24 par value, Authorized 6,000,000 shares, Issued 3,431,890 shares, Outstanding, 3,175,206 shares

Additional paid-in capital

Accumulated deficit

Less treasury stock at cost 256,684 shares

828	828
9,126	9,103
(5,777)	(6,030)
(212)	(212)

TOTAL STOCKHOLDERS EQUITY

3,965	3,689
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TOTAL LIABILITIES AND STOCKHOLDERS EQUITY

\$	12,945	\$	14,431
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See accompanying Notes to Condensed Consolidated Financial Statements.

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HALIFAX CORPORATION OF VIRGINIA
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE AND NINE MONTHS ENDED DECEMBER 31, 2009 AND 2008 (UNAUDITED)

<i>(Amounts in thousands, except share and per share data)</i>	Three Months Ended		Nine Months Ended	
	December 31,		December 31,	
	2009	2008	2009	2008
Revenues	\$ 7,659	\$ 8,120	\$ 22,963	\$ 26,043
Operating costs and expenses	6,526	6,826	19,658	21,835
Gross margin	1,133	1,294	3,305	4,208
Selling and marketing	189	183	574	587
General and administrative	768	793	2,317	2,639
Transaction costs	91		91	
Operating income	85	318	323	982
Other income	(1)	(1)	(154)	(2)
Interest expense	59	80	189	256
Income before income taxes	27	239	288	728
Income tax expense	1	7	35	66
Net income	\$ 26	\$ 232	\$ 253	\$ 662
Earnings per share basic	\$.01	\$.07	\$.08	\$.21
Earnings per share diluted	\$.01	\$.07	\$.08	\$.21
Weighted average number of shares outstanding				
Basic	3,175,206	3,175,206	3,175,206	3,175,206
Diluted	3,182,643	3,175,206	3,183,732	3,176,166

See accompanying Notes to Condensed Consolidated Financial Statements.

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HALIFAX CORPORATION OF VIRGINIA
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED DECEMBER 31, 2009 AND 2008 (UNAUDITED)

	Nine Months Ended December 31,	
<i>(Amounts in thousands)</i>	2009	2008
Cash flows from operating activities:		
Net income	\$ 253	\$ 662
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on debt extinguishment	(212)	
Depreciation and amortization	480	608
Share-based compensation	23	21
Changes in operating assets and liabilities:		
Accounts receivable	858	4,817
Inventory	(1)	431
Prepaid expenses and other assets	(202)	26
Accounts payable and accrued expenses	(977)	(773)
Deferred maintenance revenue	258	(2,373)
Income taxes payable	(26)	61
Deferred income	(40)	(44)
Net cash provided by operating activities	414	3,436
Cash flows from investing activities:		
Acquisition of property and equipment	(113)	(81)
Restricted cash	278	
Net cash provided by (used in) investing activities	165	(81)
Cash flows from financing activities:		
Proceeds from bank debt	21,327	25,606
Repayment of bank debt	(21,945)	(28,067)
Payment of auxiliary line of credit		(60)
Payments of other long-term debt	(262)	(220)
Net cash used in financing activities	(880)	(2,741)

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Net (decrease) increase in cash	(301)	614
Cash at beginning of period	484	232
Cash at end of period	\$ 183	\$ 846
Supplemental Disclosure of Cash Flow Information:		
Cash paid for interest	\$ 184	\$ 196
Cash paid for income taxes	\$ 63	\$ 4
Assets acquired under capital lease	\$ 115	\$ 162
Disposal of fully depreciated property and equipment	\$ 2,144	\$

See accompanying Notes to Condensed Consolidated Financial Statements.

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Halifax Corporation of Virginia
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Note 1 Basis of Presentation

Halifax Corporation of Virginia (the Company) is incorporated under the laws of Virginia and provides enterprise maintenance services and solutions for commercial and government activities. These services include high availability maintenance solutions, enterprise logistics solutions and technology deployment and integration. The Company is headquartered in Alexandria, Virginia and has locations to support its operations located throughout the United States.

Proposed Merger

On January 6, 2010, the Company entered into an Agreement and Plan of Merger (the Merger Agreement) with Global Iron Holdings, LLC, a Delaware limited liability company (Parent), and Global Iron Acquisition, LLC, a Delaware limited liability company (Merger Sub). The Merger Agreement provides that the Company will merge with and into Merger Sub (the Merger) with Merger Sub continuing as the surviving Company (the Surviving Entity). In the Merger, each share of common stock, par value \$0.24 per share, of the Company, issued and outstanding immediately prior to the effective time of the Merger (other than shares as to which appraisal rights are properly asserted under Virginia law and shares owned by the Company, Merger Sub, Parent or any affiliate of Parent) will be converted into the right to receive a cash amount of \$1.20 (the Merger Consideration).

As a result of the Merger, the Company will be merged with and into Merger Sub, a wholly owned subsidiary of Parent. Shareholders of the Company will not own any shares of the Surviving Entity.

Upon consummation of the Merger, each outstanding in-the-money option to purchase the Company's common stock will be converted into the right to receive a cash amount equal to the excess, if any, of the Merger Consideration over the exercise price per share for each share subject to the option, less any applicable withholding taxes. In-the-money options are options that have an exercise price per share less than \$1.20 per share. Each outstanding out-of-the-money option immediately prior to consummation of the Merger will be cancelled without consideration.

Consummation of the Merger is subject to various conditions, including the adoption of the Merger Agreement by the Company's shareholders, the absence of legal prohibitions and the receipt of requisite regulatory approvals.

Consummation of the Merger is not subject to a financing condition.

The Merger Agreement contains certain termination rights for both Parent and Merger Sub, on the one hand, and the Company, on the other hand. Upon termination of the Merger Agreement under specified circumstances, including failure to obtain the requisite shareholder vote in favor of the Merger, failure to timely hold a shareholder meeting or the Company accepting a Superior Proposal, the Company is required to pay Parent a termination fee of \$240,000 and up to \$200,000 of the reasonable expenses incurred by Parent in connection with the transactions contemplated by the Merger Agreement.

Upon termination of the Merger Agreement by the Company due to Parent's or Merger Sub's representations and warranties not being correct or Parent's or Merger Sub's failure to perform covenants contained in the Merger Agreement where such failure was not cured in all material respects within ten business days following receipt of written notice of such breach by the Company, Parent is required to pay the Company up to \$120,000 of the reasonable expenses incurred by Parent in connection with the transactions contemplated by the Merger Agreement. Subject to adoption of the Merger Agreement by the Company's shareholders and the satisfaction of the other closing conditions set forth in the Merger Agreement, the Company anticipates completing the Merger during the fourth quarter of the fiscal year ending March 31, 2010.

Prior to its execution, the Merger Agreement was approved by the Board of Directors of the Company, which based its determination to approve the Merger Agreement on the recommendation of the special committee of the Board of Directors.

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Further information regarding this transaction can be found in the Company's Current Report on Form 8-K filed with the SEC on January 12, 2010 and the Company's Definitive Proxy Statement Relating to Merger or Acquisition filed with the SEC on February 3, 2010.

In connection with this proposed merger, the Company incurred approximately \$91,000 in transaction related costs which the Company expensed during the nine months ended December 31, 2009.

On January 6, 2010, Nancy Scurlock and the Arch C. Scurlock Children's Trust, holders of the Company's 8% promissory notes totaling an aggregate principal amount of \$1.0 million at December 31, 2009 due July 1, 2010, entered into an agreement with Parent and Merger Sub to exchange at the effective time of the Merger all of the Company's 8% promissory notes for notes of same principal amount issued by the entity surviving the Merger along with other modifications such as an extension of the maturity date.

Voluntary Delisting

On September 29, 2009, the Company announced that it would voluntarily delist its common stock from the NYSE AMEX (AMEX) by filing a Form 25 with the SEC on October 9, 2009. Effective October 20, 2009, the Company's common stock was delisted from AMEX, and is currently quoted in the over-the-counter market in the Pink Sheets, a centralized electronic quotation service for over-the-counter securities. The Company's new ticker symbol for trading on the Pink Sheets is HALX. Following such delisting, the Company intends to deregister its common stock under the Securities Exchange Act of 1934 (the Exchange Act) on or about April 1, 2010, (unless deregistration occurs earlier based upon the closing of the Merger discussed above). The Company expects that it will file with the SEC a Form 15, Notice of Termination of Registration and Suspension of Duty to File, to terminate its reporting obligations under the Exchange Act on or about April 1, 2010 subject to earlier filing if the Merger transaction discussed above is completed prior to such time. When the Form 15 is filed, the Company's obligation to file reports, and other information under the Exchange Act, such as Forms 10-K, 10-Q and 8-K will be suspended. The deregistration of the Company's common stock under the Exchange Act will become effective 90 days after the date on which the Form 15 was filed. The Company is eligible to deregister under the Exchange Act, following the filing of its Annual Report on Form 10-K for the year ended March 31, 2010, because its common stock was held of record by fewer than 300 persons.

The Company's unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Wholly-owned subsidiaries include Halifax Engineering, Inc. and Halifax Realty, Inc. All significant intercompany transactions are eliminated in consolidation.

The condensed consolidated financial statements of Halifax Corporation of Virginia included herein are unaudited; however, the balance sheet as of March 31, 2009 has been derived from the audited financial statements for that date but does not include all disclosures required by accounting principles generally accepted in the United States of America (GAAP). These financial statements have been prepared by the Company pursuant to the applicable rules and regulations of the Securities and Exchange Commission (SEC). Under the SEC's regulations, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted. All significant intercompany balances and transactions have been eliminated upon consolidation, and all adjustments which, in the opinion of management, are necessary for a fair presentation of the financial position, results of operations and cash flows for the periods covered have been made and are of a normal and recurring nature. The financial statements included herein should be read in conjunction with the consolidated financial statements and the related notes thereto included in the Company's Annual Report on Form 10-K for the year ended March 31, 2009. Operating results for the three and nine months ended December 31, 2009 are not necessarily indicative of the results to be achieved for the full year.

The Company is subject to all of the risks inherent in a company that operates in the intensely competitive enterprise maintenance services and solutions industry. These risks include, but are not limited to, competitive conditions, customer requirements, technological developments, quality, pricing, responsiveness and the ability to perform within estimated time and expense guidelines. The Company's operating results may be materially affected by the foregoing factors, including its ability to manage costs in relation to revenues due to economic uncertainties.

Subsequent events have been evaluated through the filing date (February 12, 2010) of these unaudited consolidated financial statements.

Table of Contents**Note 2 New Accounting Standards**

The Financial Accounting Standards Board (FASB) has codified a single source of U.S. GAAP, the Accounting Standards Codification. Unless needed to clarify a point to readers, the Company will refrain from citing specific section references when discussing application of accounting principles or addressing new or pending accounting rule changes.

Note 3 Fair Value Measurements

Effective April 1, 2009, the Company adopted the provisions of the fair value measurement accounting and disclosure guidance related to non-financial assets and liabilities recognized or disclosed at fair value on a nonrecurring basis. This standard establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements, and clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. The provisions also establish a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The adoption of this guidance did not have a material impact on the Company's consolidated financial position, results of operations or cash flows, but requires expanded disclosures regarding the Company's fair value measurements. The Company has no financial instruments that have a materially different fair value than the respective instrument's carrying value. Because the \$1.0 million in subordinated notes with an interest rate of 8% are with a related party, it was not practicable to estimate the effect of subjective risk factors, which might influence the value of the debt. The most significant of these risk factors include the subordination of the debt and the lack of collateralization.

Note 4 Accounts Receivable

Trade accounts receivable consist of:

(Amounts in thousands)	December 31, 2009	March 31, 2009
Amounts billed	\$ 5,783	\$ 6,732
Amounts unbilled	266	239
Allowance for doubtful accounts	(113)	(177)
Accounts receivable, net	\$ 5,936	\$ 6,794

Note 5 Inventory

Inventory consists principally of spare computer parts, computer and computer peripherals consumed on maintenance contracts, and hardware and software held for resale to customers. All inventories are valued at the lower of cost or market, cost being determined principally on the weighted average cost method. The determination of market value involves numerous judgments including estimated average selling prices based upon recent sales volumes, industry trends, existing customer orders, current contract price, future demand and pricing for its products and technological obsolescence of the Company's products. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

The Company's reserve for excess and obsolete inventory at December 31, 2009 and March 31, 2009 was approximately \$0.8 million and \$1.2 million, respectively. During the three months ended December 31, 2009 and 2008, the Company recorded inventory obsolescence charges in the amount of \$0 and \$100,000, respectively. During the nine months ended December 31, 2009 and 2008, the Company recorded inventory obsolescence charges in the amount of \$150,000 and \$212,000, respectively.

In valuing its inventory costs, the Company considered whether the utility of the products delivered or expected to be delivered at less than cost, primarily comprised of computer parts and equipment consumed on maintenance contracts, had declined. The Company concluded that, in the instances where the utility of the products delivered or expected to

be delivered were less than cost, it was appropriate to value the inventory costs at cost or market, whichever is lower, thereby recognizing the cost of the reduction in utility in the period in which the reduction occurred or can be reasonably estimated. The Company has, therefore, recorded inventory write-downs as necessary in each period in order to reflect inventory at the lower of cost or market.

Table of Contents**Note 6 Goodwill and Other Intangible Assets**

The Company evaluates goodwill and intangibles with an indefinite life annually during the third fiscal quarter and upon the occurrence of certain triggering events or substantive changes in circumstances that indicate that the fair value of goodwill or indefinite lived intangible assets may be impaired. Impairment of goodwill is tested at the reporting unit level. The Company has one reporting unit, because none of the components of the Company constitute a business for which discrete financial information is available and for which Company management regularly reviews the results of operations.

The goodwill impairment test follows a two step process. In the first step, the fair value of a reporting unit is compared to its carrying value. If the carrying value of a reporting unit exceeds its fair value, the second step of the impairment test is performed for purposes of measuring the impairment. In the second step, the fair value of the reporting unit is allocated to all of the assets and liabilities of the reporting unit to determine an implied goodwill value. This allocation is similar to a purchase price allocation. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of goodwill, an impairment loss will be recognized in an amount equal to that excess. As the Company consists of only one reporting unit, and is publicly traded, management estimates of the fair value were prepared by weighting three different valuation methods: the discounted cash flow method, the mergers and acquisition method and an indication to value based on the quoted market price of the Company's stock. The Company heavily weighted the discounted cash flow method and the mergers and acquisition method in determining the fair value of the reporting unit. Due to the lack of an active trading market for the Company's stock, the Company's quoted market price was not considered as strong an indication of value of the reporting unit.

In response to market conditions, the Company evaluated its goodwill position at March 31, 2009, by comparing the fair value of the reporting unit with its carrying value, including goodwill, and determined that the fair value of reporting unit was greater than the carrying value and the goodwill balance and indefinite lived intangible assets were not impaired. In connection with the proposed Merger (See Note 1), the Company updated its goodwill impairment test as of December 31, 2009, to identify whether a potential impairment of the Company's recorded goodwill existed. The Company completed its updated impairment test as of December 31, 2009 and determined that there was no impairment to the recorded goodwill balance of \$2.9 million. The Company will continue to monitor its goodwill and indefinite-lived intangible and long-lived assets for possible future impairment.

Note 7 Accounts Payable

Accounts payable represents amounts owed to third parties at the end of the period. The Company included drafts outstanding in accounts payable of approximately \$582,000 and \$387,000 at December 31, 2009 and March 31, 2009, respectively.

Note 8 Accrued Expenses

Accrued expenses consist of the following:

	December 31, 2009	March 31, 2009
Accrued lease payments	\$ 311	\$ 832
Accrued vacation	21	21
Accrued payroll	210	357
Payroll taxes accrued and withheld	109	143
Interest	331	325
Other accrued expenses	319	614
	\$ 1,301	\$ 2,292

Table of Contents**Note 9 Income Taxes**

As of December 31, 2009 and March 31, 2009, the Company maintained a valuation allowance against deferred tax assets, as the Company concluded it did not meet the more likely than not threshold to reverse the valuation allowance. As such, the Company's effective tax rate for the three and nine months ended December 31, 2009 and 2008 differs from the statutory rate primarily due to the Company's utilization of deferred tax assets offset by the associated valuation allowance. The income tax expense for the three and nine months ended December 31, 2009 and 2008 consisted primarily of federal and state alternative minimum taxes and other state taxes.

The Company's unrecognized tax benefits were unchanged during the three and nine months ended December 31, 2009. The Company does not anticipate that total unrecognized tax benefits will significantly change due to the settlement of examinations or the expiration of the statute of limitations within the next twelve months.

Note 10 Credit Facility and Subordinated Debt*Credit Facility*

On June 15, 2009, the Company entered into a Business Loan Agreement (the "Loan Agreement"), and a Commercial Security Agreement (the "CSA"), with Sonabank (the "New Credit Facility"). The Company also executed a promissory note (the "Note") in favor of Sonabank. Collectively, the Loan Agreement, the CSA and the Note are referred to as the Loan Documents. The Loan Documents replaced the Company's Loan and Security Agreement with Textron Financial Corporation, which terminated on June 15, 2009 (the "Old Credit Facility"). On August 26, 2009, the Company entered into an amendment to the note dated June 15, 2009 in favor of Sonabank effective beginning September 1, 2009.

Under the amendment the amount that the Company may borrow was increased from \$1.5 million to \$3.0 million. Additionally, as long as the Company maintains a debt service coverage ratio of 1.25, the Company may make quarterly interest payments on the 8% promissory notes dated November 2, 1998 and November 5, 1998.

In connection with the amendment, Sonabank released the personal guarantees of both, the Company's Chief Executive Officer and the Company's former Chief Financial Officer.

The Loan Agreement has a term of one year. In the event that the Company pays and closes a new credit facility prior to June 15, 2010 with another lender, the Company must pay a 2% penalty assessed based on the maximum credit limit of the New Credit Facility.

Under the Loan Documents, the Company may borrow an amount that may not exceed the lesser of: (i) \$3,000,000 or (ii) the borrowing base which is 85% of the value of eligible accounts (as defined in the Note). The amount outstanding under the loan was approximately \$1.7 million at December 31, 2009. At December 31, 2009, the Company had approximately \$678,000 available under the New Credit Facility.

Interest accrues on the outstanding balance of the Note at an initial rate of 8% per annum. The interest rate on the New Credit Facility is a variable rate per annum adjusted daily based upon the Wall Street Journal's prime lending rate plus 2.75%. Under no circumstances will the interest rate be less than 8%. The Company must pay regular monthly payments of all accrued unpaid interest due as of each payment date.

The Company's Loan Documents require the lender's approval for the payment of dividends or distributions.

The New Credit Facility is secured by all of the Company's assets. The Company is required to assign all receivables payments, collections, and proceeds of receivables to Sonabank and post any of these amounts to the designated lock-box account.

For more information on the Company's Loan Agreement see, Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources.

Subordinated Debt Affiliates

As of December 31, 2009 and March 31, 2009, Nancy Scurlock and the Arch C. Scurlock Children's Trust, which are shareholders of the Company, held, \$500,000 and \$500,000 face amount of the Company's 8% Promissory Notes dated November 2, 1998 and November 5, 1998, respectively. Interest expense on the subordinated debt totaled \$20,000 for three months ended December 31, 2009 and 2008, respectively. Interest expense on the subordinated debt totaled \$60,000 for the nine months ended December 31, 2009 and 2008, respectively. The principal amount outstanding under the subordinated notes was \$1.0 million in the aggregate at December 31, 2009. The maturity date of the notes has been extended to July 1, 2010. The balance of accrued but unpaid interest due on the 8% promissory notes was approximately \$322,000 and \$302,000 at December 31, 2009 and March 31, 2009, respectively. During the

three months ended December 31, 2009, the Company paid \$10,000 in accrued interest, (\$20,000 in the aggregate) to Nancy Scurlock and the Arch C. Scurlock Children's Trust. During the nine months ended December 31, 2009, the Company paid \$20,000 in accrued interest, (\$40,000 in the aggregate) to Nancy Scurlock and the Arch C. Scurlock Children's Trust.

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In connection with the proposed Merger discussed in Note 1, the holders of the Company's \$1,000,000 subordinated notes have agreed to certain modifications to the notes including extension of the maturity dates. These amendments to the outstanding notes are contingent on the consummation of the proposed Merger.

Note 11 Gain on Extinguishment of Debt

In June 2009, the Company completed the repurchase of approximately \$2.6 million of debt outstanding under the Old Credit Facility for approximately \$2.4 million. The repurchase of the debt resulted in the recognition of a gain on extinguishment of debt of approximately \$212,000 for the nine months ended December 31, 2009, which is included in other income, on the condensed consolidated statements of operations.

Note 12 Stock Based Compensation

During the nine months ended December 31, 2009, there was a grant of stock options to purchase 5,000 shares of common stock at \$1.16 under the Company's 2005 Stock Option and Incentive Plan. During the nine months ended December 31, 2009, 500 options terminated pursuant to their terms and no exercises of options occurred.

During the nine months ended December 31, 2009, there were 59,000 options terminated and no exercises of options under the Company's 1994 Key Employee Stock Option Plan and Non-Employee Directors Stock Option Plan. No new grants may be made under the 1994 Key Employee Stock Option Plan or Non-Employee Directors Stock Option Plan.

The intrinsic value of stock options outstanding at December 31, 2009 was \$200.

As of December 31, 2009, there was \$24,000 of total unrecognized compensation cost related to nonvested share-based compensation arrangements. This cost is expected to be fully amortized in five years.

For the three months ended December 31, 2009 and 2008, the Company recorded share based compensation expense of approximately \$8,000 and \$7,000, respectively. For the nine months ended December 31, 2009 and 2008, the Company recorded share based compensation expense of approximately \$23,000 and \$21,000, respectively.

Note 13 Earnings per Share

The computation of basic earnings per share is based on the weighted average number of shares outstanding during the period. Diluted earnings per share is based on the weighted average number of shares including adjustments to both net income and shares outstanding when dilutive, including potential common shares from options and warrants to purchase common stock using the treasury stock method.

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The following table sets forth the computation of basic and diluted earnings per share.

<i>(Amounts in thousands except share data)</i>	Three Months Ended		Nine Months Ended	
	December 31, 2009	December 31, 2008	December 31, 2009	December 31, 2008
Numerator for earning per share:				
Net income	\$ 26	\$ 232	\$ 253	\$ 662
Denominator:				
Denominator for basic earnings per share weighted-average shares	3,175,206	3,175,206	3,175,206	3,175,206
Effect of dilutive securities:				