ESSEX CORPORATION
Form 10-Q
August 11, 2004

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

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES AND EXCHANGE ACT OF 1934

For the quarterly period ended June 27, 2004

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES AND EXCHANGE ACT OF 1934

For the Transition period from to

Commission File Number 0-10772

ESSEX CORPORATION
(Exact name of registrant as specified in its charter)

Virginia	54-0846569
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
9150 Guilford Road, Columbia, Maryland	21046
(Address of principal executive offices)	(Zip Code)

(301) 939-7000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES X NO

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

YES NO X

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

CLASS	OUTSTANDING AT JULY 22, 2004
Common Stock, no par value per share	15,180,952

ESSEX CORPORATION

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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References hereinafter to the quarter(ly) and six month periods represent the 13-week and 26-week periods, respectively, ending on the date indicated.

ESSEX CORPORATION

CONSOLIDATED BALANCE SHEETS

	June 27, 2004	December 28, 2003
	(Unaudited)	
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 15,981,395	$ 31,835,294
Accounts receivable, net	14,819,527	3,969,601
Prepayments and other	653,443	146,517
Total Current Assets	31,454,365	35,951,412
PROPERTY AND EQUIPMENT		
Computers and special equipment	1,539,311	1,226,349
Furniture, equipment and other	732,588	250,138
	2,271,899	1,476,487
Accumulated depreciation and amortization	(1,246,103)	(1,107,790)
Net Property and Equipment	1,025,796	368,697

OTHER ASSETS		
Goodwill	13,915,455	2,998,000
Patents, net	326,134	333,648
Other intangibles, net	683,842	50,141
Other	269,482	23,764
Total Other Assets	15,194,913	3,405,553
TOTAL ASSETS	$ 47,675,074	$ 39,725,662

ESSEX CORPORATION

CONSOLIDATED BALANCE SHEETS

	June 27, 2004	December 28, 2003
	(Unaudited)	
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 6,026,672	$ 694,434
Note payable	--	100,000
Accrued wages and vacation	1,526,718	898,498
Accrued retirement plans contribution payable	151,336	298,551
Advance payments	492,568	462,000
Other accrued expenses	444,669	522,538
Capital leases	12,000	4,390
Total Current Liabilities	8,653,963	2,980,411
LONG-TERM DEBT		
Capital lease, net of current portion	35,165	--
Total Liabilities	8,689,128	2,980,411
SHAREHOLDERS' EQUITY		
Common stock, no par value; 25 million shares authorized; 15,116,329 and 15,241,257 shares issued and outstanding, respectively	50,452,771	49,004,021
Additional paid-in capital	2,000,000	2,000,000
Accumulated deficit	(13,466,825)	(14,258,770)
Total Shareholders' Equity	38,985,946	36,745,251
TOTAL LIABILITIES AND SHAREHOLDERS'		

EQUITY	$ 47,675,074	$ 39,725,662

ESSEX CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS
UNAUDITED

	Six Month Period Ending June 27, 2004	Six Month Period Ending June 29, 2003	Quarterly Period Ending June 27, 2004	Quarte Period June 29
Revenues:				
Services and products	$ 22,808,163	$ 7,149,941	$ 14,539,612	$ 4,1
Purchased hardware	12,035,922	--	6,063,368	
Total	34,844,085	7,149,941	20,602,980	4,1
Costs of goods sold and services provided:				
Services and products	(17,203,129)	(4,661,942)	(11,068,126)	(2,6
Purchased hardware	(11,838,197)	--	(5,978,115)	
Total	(29,041,326)	(4,661,942)	(17,046,241)	(2,6
Gross Margin	5,802,759	2,487,999	3,556,739	1,5
Selling, general and administrative expenses	(4,526,463)	(1,990,251)	(2,692,173)	(1,2
Research and development	(447,215)	(226,040)	(306,756)	(
Amortization of other intangible assets	(162,299)	(174,017)	(127,158)	(1
Operating Income	666,782	97,691	430,652	1
Interest income (expense), net	125,161	(43,199)	49,440	(
Income Before Income Taxes	791,943	54,492	480,092	
Provision for income taxes	--	--	--	
Net Income	$ 791,943	$ 54,492	$ 480,092	$
Basic Earnings Per Common Share	$ 0.05	$ 0.01	$ 0.03	$

Diluted Earnings Per Common Share	$ 0.05	$ 0.01	$ 0.03	$
WEIGHTED AVERAGE NUMBER OF SHARES				
Basic	15,045,973	8,437,723	15,085,778	8,9
Effect of dilution - Stock options	1,379,821	1,128,075	1,379,821	1,1
Diluted	16,425,794	9,565,798	16,465,599	10,0

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ESSEX CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

UNAUDITED

	Six Months Ended June 27, 2004	Six Mon Ended Ju 200
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	$ 791,943	$
Adjustments to reconcile Net Income to Net Cash Used In Operating Activities:		
Depreciation and amortization	157,840	
Amortization of other intangible assets	162,299	1
Contract reserves/account allowance	120,000	
Other	--	
Change in Assets and Liabilities:		
Accounts receivable	(8,439,756)	(1,1
Prepayments and other assets	(313,934)	(
Advance payments	30,568	(1
Accounts payable	4,918,438	(1
Accrued wages, vacation and retirement	171,380	5
Other liabilities	(135,645)	
Net Cash Used In Operating Activities	(2,536,867)	(5
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisitions, net of cash acquired	(14,179,531)	(3
Purchases of property and equipment	(479,026)	(
Other	--	

Net Cash Used In Investing Activities	(14,658,557)	(3
CASH FLOWS FROM FINANCING ACTIVITIES:		
Sales of common stock	1,192,125	
Note payable	(100,000)	1
Exercise of stock options	256,625	
Short-term borrowings/repayments, net	--	3
Payment of capital lease obligations	(7,225)	(
Net Cash Provided By Financing Activities	1,341,525	3
CASH AND CASH EQUIVALENTS		
Net decrease	(15,853,899)	(4
Balance - beginning of period	31,835,294	1,0
Balance - end of period	$ 15,981,395	$ 5

ESSEX CORPORATION

NOTES TO INTERIM UNAUDITED CONSOLIDATED FINANCIAL INFORMATION

NOTE 1: General

FISCAL YEAR AND PRESENTATION

These statements cover Essex Corporation (the "Company"), its formerly wholly-owned subsidiary, Sensys Development Laboratories, Inc. ("SDL"), which was acquired effective March 1, 2003 and merged into the Company effective December 30, 2003 and its wholly-owned subsidiary, Computer Science Innovations, Inc. ("CSI"), which was acquired effective April 30, 2004. On June 25, 2004, the Company completed the acquisition of substantially all of the assets of Performance Group, Inc. ("PGI"). The Company is on a 52/53-week fiscal year ending the last Sunday in December. Years 2004 and 2003 are 52-week fiscal years. References to the quarter(ly) and six month periods represent the 13-week and 26-week periods, respectively, ending on the date indicated. All material intercompany transactions have been eliminated. Certain amounts for 2003 have been reclassified to conform to the 2004 presentation.

The information furnished in the accompanying Unaudited Consolidated Balance Sheets, Unaudited Consolidated Statements of Operations and Unaudited Consolidated Statements of Cash Flows have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. In the opinion of management, such information contains all adjustments considered necessary for a fair presentation of such information. The operating results for the twenty-six week period ended June 27, 2004 may not be indicative of the results of operations for the year ending December 26, 2004, or any future period. This financial information should be read in conjunction with the Company's 2003 audited consolidated financial statements and footnotes thereto, included in the Annual Report on Form 10-K filed with the Securities and Exchange Commission.

USE OF ESTIMATES

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates are used when accounting for uncollectible accounts receivable, inventory obsolescence and valuation, depreciation and amortization, intangible assets, employee benefit plans and contingencies, among others. Actual results could differ from these estimates.

RESEARCH AND DEVELOPMENT

Research and development costs are expensed as incurred. Such costs include direct labor and materials as well as a reasonable allocation of indirect costs. However, no general and administrative costs are included in research and development. Equipment which has alternative future uses is capitalized and charged to expense over its estimated useful life.

NOTE 2: Basic and Diluted Earnings Per Share

Basic earnings per common share are computed using the weighted average number of common shares outstanding during the period reduced by contingently returnable shares. Diluted earnings

per common share incorporates the incremental shares issuable upon the assumed exercise of stock options and warrants. As of June 27, 2004 and June 29, 2003, the effect of the incremental shares from options, warrants and contingent shares (if applicable) of 111,100 and 2,368,700, respectively, have been excluded from diluted weighted average shares as the effect would have been antidilutive or contingencies were not resolved.

NOTE 3: Common Stock

The Company completed a follow-on public offering in December 2003 and issued 4,000,000 shares of common stock. The Company received net proceeds of $31.4 million. In January 2004, the underwriters exercised their over allotment option and the Company sold an additional 150,000 common shares and received net proceeds of $1.2 million.

In connection with the acquisition of SDL, the Company had issued approximately 422,000 common shares into escrow. These shares were to be released to certain SDL shareholders or returned to Essex based upon certain factors, principally the future market price of the Company's stock. During the first quarter of 2004, the 422,000 shares in escrow were returned to the Company in accordance with the terms of the purchase agreement.

NOTE 4: Stock-Based Compensation

The Company accounts for stock options granted to employees and directors using the intrinsic value based method of accounting. Under this method, the Company does not recognize compensation expenses for the stock options because the exercise price is equal to the market price of the underlying stock on the date of the grant. If the Company had used the fair value based method of accounting, net earnings and earnings per share would have been reduced to the pro forma amounts listed in the table below. The Black-Scholes option pricing model was used to calculate the pro forma stock-based compensation costs. For purposes of the pro forma disclosures, the assumed compensation expense is amortized over the option's vesting periods. The pro forma information is consistent with assumptions used in the year end calculations. Accordingly, net income (loss) and earnings (loss) per share would be as follows:

	Six Months Ended		Three Months E	
	June 27, 2004	June 29, 2003	June 27, 2004	Jun
Net income, as reported	$ 791,943	$ 54,492	$ 480,092	$
Less: Total stock-based employee compensation expense determined under fair value based method	979,275	392,570	218,022	
Pro forma (loss) income	$ (187,332)	$ (338,078)	$ 262,070	$
Earnings (loss) per share:				
Basic-as reported	$ 0.05	$ 0.01	$ 0.03	$
Basic-pro forma	$ (0.01)	$ (0.04)	$ 0.02	$
Diluted-as reported	$ 0.05	$ 0.01	$ 0.03	$
Diluted-pro forma	$ (0.01)	$ (0.04)	$ 0.02	$

ESSEX CORPORATION

NOTES TO INTERIM UNAUDITED CONSOLIDATED FINANCIAL INFORMATION

NOTE 5: Amortization of Other Intangible Assets

In connection with the March 1, 2003 acquisition of SDL, there was $431,000 of intangible value assigned primarily to contracts. In connection with the April 30, 2004 acquisition of CSI, there was $724,000 of value assigned primarily to contracts. In connection with the June 25, 2004 acquisition of substantially all of the assets from Performance Group, Inc., there was $70,000 of value assigned, primarily to covenants not to compete. (See Note 7.) Amortization of $127,000 and $162,000 was recognized in the quarter and six months ended June 27, 2004, respectively. Amortization of $128,000 and $174,000 was recognized in the quarter and six month periods ended June 29, 2003, respectively.

NOTE 6: Income Taxes

The Company is in a net operating loss (NOL) carryforward position for book and tax purposes.

The Company has established a valuation reserve for all of its deferred tax assets. Such tax assets are available to be recognized and benefit future periods. The evaluation of the realizability of deferred tax assets in future periods is made annually at year end based upon a variety of factors for generating future taxable income, such as historical and projected operating performance. The Company had a deferred income tax asset valuation allowance of $3.5 million at December 28, 2003.

NOTE 7: Acquisitions

In April 2004, the Company agreed to acquire 100% of the common stock of Computer Science Innovations, Inc. ("CSI"), which is headquartered in Melbourne, Florida, for approximately $8.1 million in cash. The Company incurred another $125,000 in related legal and accounting fees. CSI has proprietary techniques, algorithms and tools that are used to build custom "cognitive engines" for a broad range of intelligence, defense and commercial customers and applications. CSI had revenue of approximately $7.5 million in its fiscal year ended March 31, 2004. The Company closed this transaction effective April 30, 2004.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition.

Current assets	$ 1,465,000
Equipment and other	172,000
Goodwill	6,414,000
Intangible assets	724,000
Total assets acquired	8,775,000
Current liabilities	(550,000)
Net assets acquired	$ 8,225,000

The intangible assets of $724,000 are primarily assigned to contracts which have an estimated overall amortization life of less than one year. The allocation of the purchase price is preliminary and subject to adjustment following completion of the valuation process.

The following information is presented on a pro forma basis as though the business combination had been completed as of the beginning of fiscal 2004.

	For The Six Months Ended June 27, 2004 (in Thousands) (Unaudited)	
	As Reported	Pro Forma
Revenues	$ 34,844	$ 36,972
Net Income	$ 792	$ 503
Earnings Per Share:		
Basic	$ 0.05	$ 0.03
Fully diluted	$ 0.05	$ 0.03

On June 25, 2004, the Company completed the acquisition of substantially all of the assets of Performance Group, Inc. ("PGI") with main offices in Fredericksburg, VA. PGI provides services and systems in the areas of Geographic Information Systems (GIS), Imagery Processing and Analysis, Spatial Data Development, Environmental Consulting, Visualization, and IT Solutions to government and private sector clients. PGI had revenue of approximately $4.5 million in calendar year 2003.

The Company paid $5.85 million in cash and assumed $231,000 of liabilities. The Company also incurred $125,000 in outside expenses.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition.

Current assets	$ 1,516,000
Equipment and other	117,000
Goodwill	4,503,000
Intangible assets	70,000
Total assets acquired	6,206,000
Current liabilities	(231,000)
Net assets acquired	$ 5,975,000

NOTES TO INTERIM UNAUDITED CONSOLIDATED FINANCIAL INFORMATION

The Company is in the process of evaluating the intangible assets acquired, such as contracts. The allocation of the purchase price is preliminary and subject to adjustment following completion of the valuation process.

NOTE 8: Statements of Cash Flows - Supplemental Disclosure

There was a $50,000 capital lease entered into in the first six months of 2004. There were no new capital leases in the first six months of 2003.

In connection with the acquisition of substantially all of the assets of PGI, the Company assumed approximately $231,000 of liabilities which are expected to be paid in the third quarter of 2004.

NOTE 9: Major Customers

Most of the Company's revenues are derived from contracts with the U.S. Government, where the Company is either the prime contractor or a subcontractor, depending on the contract. For the first six months ended June 27, 2004 and June 29, 2003, revenues derived from U.S. Government programs were $34.3 million, or 98.5% and $7.1 million, or 98.6%, of the Company's total revenues, respectively. For the first six months ended June 27, 2004, approximately $24.9 million or 71.6% of revenues were derived from one U.S. Government customer on one program.

ESSEX CORPORATION

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

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS AND OTHER SECTIONS CONTAIN FORWARD-LOOKING STATEMENTS THAT ARE BASED ON MANAGEMENT'S EXPECTATIONS, ESTIMATES, PROJECTIONS AND ASSUMPTIONS. WORDS SUCH AS "EXPECTS", "ANTICIPATES", "PLANS", "BELIEVES", "ESTIMATES" AND VARIATIONS OF SUCH WORDS AND SIMILAR EXPRESSIONS ARE INTENDED TO IDENTIFY SUCH FORWARD-LOOKING STATEMENTS THAT INCLUDE, BUT ARE NOT LIMITED TO, PROJECTIONS OF REVENUES, EARNINGS, SEGMENT PERFORMANCE, CASH FLOWS AND CONTRACT AWARDS. SUCH FORWARD-LOOKING STATEMENTS ARE MADE PURSUANT TO THE SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995. THESE STATEMENTS ARE NOT GUARANTEES OF FUTURE PERFORMANCE AND INVOLVE CERTAIN RISKS AND UNCERTAINTIES THAT ARE DIFFICULT TO PREDICT. FOR MORE INFORMATION ON RISK FACTORS, SEE THE COMPANY'S ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED DECEMBER 28, 2003. THEREFORE, ACTUAL FUTURE RESULTS AND TRENDS MAY DIFFER MATERIALLY FROM WHAT IS INDICATED IN FORWARD-LOOKING STATEMENTS DUE TO A VARIETY OF FACTORS. REFERENCES TO THE QUARTER(LY) AND SIX MONTH PERIODS REPRESENT THE 13-WEEK AND 26-WEEK PERIODS, RESPECTIVELY, ENDING ON THE DATE INDICATED.

OVERVIEW

Essex Corporation (the "Company") provides advanced optoelectronic and signal processing services and products for U.S. Government intelligence and defense customers and communications customers with whom we have established and maintained long-standing and successful relationships. The Company provides optoelectronic and signal processing services to classified U.S. Government customers under next generation research and development contracts. The Company supports the intelligence community's mission critical voice and video systems infrastructure. The Company provides systems fabrication, software integration, testing, field deployment and other engineering services to highly classified U.S. Government customers. The Company builds optical communications and networking system elements and components, as well as signal and image processing software products. While the Company has historically sold our products to the intelligence and defense markets, we believe our existing products and our patent portfolio position us well to benefit from spending on next generation technology that decreases the costs and increases the speed, performance and security of existing communications networks.

With its acquisition of Computer Science Innovations, Inc. in April 2004, the Company now has proprietary techniques, algorithms and tools that are used to build custom "cognitive engines" for a broad range of intelligence, defense and commercial customers and applications. With the acquisition of substantially all of the assets of Performance Group, Inc. in June 2004, the Company now has services and systems in the areas of Geographic Information Systems (GIS), Imagery Processing and Analysis, Spatial Data Development, Environmental Consulting, Visualization, and IT Solutions for government and private sector clients.

Most of the Company's revenues are derived from contracts with the U.S. Government, where the Company is either the prime contractor or a subcontractor, depending on the contract. For the six months ended June 27, 2004 and June 29, 2003, revenues derived from U.S. Government programs were $34.3 million, or 98.5%, and $7.1 million, or 98.6%, of the Company's total revenues, respectively. The Company received a substantial amount of its intelligence and defense community revenues for 2004 and 2003 from sole source contracts.

The Company's most significant expense is its cost of goods sold and services provided, which consists primarily of direct labor and associated costs for program personnel and direct expenses incurred to complete contracts, including the cost of materials and equipment and subcontract efforts. The Company's ability to accurately predict personnel requirements, salaries and other costs, as well as to manage personnel levels and successfully redeploy personnel, can have a significant impact on its cost of goods sold and services provided. Selling, general and administrative expenses consist primarily of costs associated with the Company's management, finance and administrative groups and business development expenses which include bid and proposal efforts, and occupancy, travel and other corporate costs.

STATUS

The Company has experienced significant growth in its U.S. Government business and has been actively pursuing growth strategies from internal efforts and external merger sources. These efforts have resulted in profitable operations for the first half of 2004 and fiscal 2003. The Company completed, effective March 1, 2003, the acquisition of Sensys Development Laboratories, Inc. ("SDL"), a Maryland-based provider of system and software engineering support services. This merger added over 25 highly skilled professionals to the Company's staff and approximately $6 million of annual revenue for 10 months in 2003. The Company completed, effective April 30, 2004, the acquisition of Computer Science Innovations, Inc. ("CSI"), which is headquartered in Melbourne, Florida, for approximately $8.1 million in cash and incurred an additional $125,000 in legal and accounting fees. CSI has proprietary techniques, algorithms and tools that are used to build custom "cognitive engines" for a broad range of intelligence, defense and commercial customers and applications. CSI had revenue of approximately $7.5 million in its fiscal year ended March 31, 2004. The Company completed, effective June 25, 2004, the acquisition of substantially all of the assets of Performance Group, Inc. ("PGI") with main offices in Fredericksburg, Virginia for approximately $5.85 million in cash and assumed $231,000 in liabilities. The Company also incurred $125,000 in outside expenses. PGI provides services and systems in the areas of Geographic Information Systems (GIS), Imagery Processing and Analysis, Spatial Data Development, Environmental Consulting, Visualization, and IT Solutions to government and private sector clients. PGI had revenue of approximately $4.5 million in calendar year 2003.

In October 2003, the Company was awarded a new defense-related contract for approximately $57 million over 4 years (a 3 month base period plus 4 option years). This is a delivery order contract for software and systems engineering and the delivery of custom systems to national priority programs. The Company is the prime contractor and there are numerous team members/subcontractors who will work on this program. In the second quarter of 2004, in connection with this contract, the Company leased over 50,000 square feet of space. The lease extends until May 2011 with an option for early termination. The space will contain significant floor space to provide highly classified work areas as well as assembly, warehouse and regular office space. The Company expects to recover the majority of the costs of this facility via direct or indirect charges to this and other contracts.

The Company continues to patent, develop and commercialize its key leading-edge optical technologies, principally the fiberoptic HYPERFINE WDM devices and wireless optical processor enhanced receiver architecture (OPERA(TM)) technology. The purpose of the HYPERFINE WDM device is to increase the number of usable communications channels within a single optical fiber.

The purpose of OPERA(TM) is to increase capacity and improve voice and data quality of wireless systems.

Prototypes of the HYPERFINE WDM technology are being demonstrated to prospective strategic partners and investors. During the first nine months of 2003, the Company sold ten of its initial HYPERFINE WDM family devices consisting of five prototype demultiplexers and five of the new flat-top HYPERFINE WDM devices for use in building advanced optical code division multiple access (OCDMA) systems for $457,000 to several government and intermediate customers. The Company is also developing applications for using HYPERFINE WDM to achieve privacy in an all optical network. The Company is developing simulations of its OPERA(TM) wireless receiver device technology and is undertaking to determine the various market entry points for such device technology. The Company is also holding discussions with various established entities that are in the wireless communications market in order to determine the best communications applications of such technology.

The Company was awarded a patent for its HYPERFINE WDM technology in August 2003. In light of the continued unfavorable conditions in the communications markets, the market for our optical technologies and products has been slow in developing; however, as indicated above, we sold in fiscal 2003 the first 10 HYPERFINE WDM family devices to our customers in the intelligence and defense communities. As noted previously, we are significantly expanding our U.S. Government business base. The expansion is designed to take advantage of our government contracting experience and technical expertise and the increased government contracting activity in the defense, intelligence and homeland security areas. We are selling our HYPERFINE WDM and other optical technologies in the government marketplace and will continue to pursue such sales in the commercial markets.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company re-evaluates its estimates, including those related to revenue recognition, R&D, inventories, intangible assets, income taxes and contingencies. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The Company believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its financial statements.

REVENUE RECOGNITION

The Company enters into three types of U.S. Government contracts: cost plus fixed fee, fixed price and time and material. The Company recognizes revenue on cost plus fixed fee contracts to the extent costs are incurred plus a proportionate amount of fee earned. The Company must determine that the costs incurred are proper and that the ultimate costs incurred will not overrun the expected funding on the contract and still deliver the scope of work proposed. Even though cost plus fixed fee contracts generally do not require that the Company expend costs in excess of the contract value, such expenditures may be required in order to achieve customer satisfaction

and receive additional work. In addition, since the reimbursable costs include both direct and indirect costs, the Company must determine that the indirect costs are properly accounted for and allocated in accordance with government cost accounting requirements. On fixed price service contracts, the Company must determine that the costs incurred provide a proportionate amount of progress on the work and that the ultimate costs incurred will not overrun the funding on the contract and the required hours will be delivered. On fixed price product orders, revenue is not recorded until the Company determines that the goods have been delivered and accepted by the customer. On time and material contracts, revenue is recognized to the extent of billable rates multiplied by hours delivered, plus other direct costs. This is generally the most straightforward revenue computation. The Company uses historical technical performance experience where applicable to evaluate progress on fixed price and cost plus fixed fee jobs. The Company uses historical government audit experience in the indirect cost area to evaluate the propriety and expected recovery of its indirect costs on cost plus fixed fee contracts.

RESEARCH AND DEVELOPMENT

The Company has expended significant amounts for research and development for new products. In accordance with generally accepted accounting principles, the Company expenses and does not capitalize and add to inventory such expenditures. When product design and prototypes are finalized and product marketability and viability have been established, expenditures for inventory are treated accordingly. There is a judgmental aspect to this decision which could result in the over-expensing in some cases or the early capitalization in other cases of such expenditures. The Company had no inventory balance as of June 27, 2004.

GOODWILL AND OTHER INTANGIBLE ASSETS

The Company's business acquisitions typically result in goodwill and other intangible assets, which affect the amount of future period amortization expense and possible impairment expense that the Company will incur. The Company has adopted Statement of Financial Accounting Standards ("SFAS") No. 142 "Goodwill and Other Intangible Assets", which requires that the Company, on an annual basis, calculate the fair value of the reporting units that contain the goodwill and compare that to the carrying value of the reporting unit to determine if impairment exists. Impairment testing must take place more often if circumstances or events indicate a change in the impairment status. Management judgment is required in calculating the fair value of the reporting units.

ESSEX CORPORATION

RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, the percentage of items in the statement of operations in relation to total revenue (or respective revenue with regard to cost of goods sold).

	Six Months Ended (unaudited)				Quarterly Perio (unaudite	
	June 27, 2004		June 29, 2003		June 27, 2004	
Revenues:	%	%	%	%	%	%
Services and products		65.5		100.0		70.6
Purchased hardware		34.5		--		29.4
Total		100.0		100.0		100.0
Costs of goods sold and services provided:						
Services and products	(75.4)		(65.2)		(76.1)	
Purchased hardware	(98.4)		--		(98.6)	
Total		(83.3)		(65.2)		(82.7)
Gross Margin		16.7		34.8		17.3
Selling, general and administrative expenses		(13.0)		(27.8)		(13.1)
Research and development		(1.3)		(3.2)		(1.5)
Amortization of other intangible assets		(0.5)		(2.4)		(0.6)

Operating income	1.9	1.4	2.1
Interest income (expense), net	0.4	(0.6)	0.2
Income before income taxes	2.3	0.8	2.3
Provision for income taxes	0.0	0.0	0.0
Net income	2.3	0.8	2.3

REVENUES. Total revenues were $34.8 million and $7.1 million in the first six months of fiscal 2004 and 2003, respectively. Total revenues were $20.6 million and $4.1 million in the second quarters of fiscal 2004 and 2003, respectively. The key factors for the higher revenue were the increased activity on the October 2003 $57.0 million multi-year award and the January 2004 $4.5 million two-year award for software and systems engineering and the delivery of custom systems to national priority programs. Revenues from these two awards in the first half of 2004 were $24.9 million and $2.1 million, respectively. Of this total $27.0 million, $12.0 million was for purchased hardware. Revenues from these two awards in the second quarter of 2004 were $15.6 million and $500,000, respectively. Of this total $16.1 million, $6.1 million was for purchased hardware. There was no comparable purchased hardware revenue in the first half of 2003. The Company had $1.1 million in service and products revenue in the second quarter of 2004 for the 2 months of operations from its acquisition of CSI.

COST OF GOODS SOLD AND SERVICES PROVIDED ("CGS"). Total CGS increased $24.3 million to $29.0 million for the first six months of 2004 from $4.7 million for the comparable period in 2003. As a percentage of total revenues, total CGS was approximately 83.3% for the first half of 2004, compared to approximately 65.2% for the comparable period in fiscal 2003. For services and products revenue, CGS was 75.4% for the first half of 2004 as compared to 65.2% for the comparable period in 2003. The increase in CGS reflects increased volume and revenue for the period. The increase in CGS as a percentage of revenue reflects the change in the mix of work, primarily related to the two contracts awarded in October 2003 and January 2004. Specifically, upon award and ramp up, a majority of the revenues under those contracts relate to subcontracts and purchased hardware which are lower margin. Over time, we anticipate a gradual shift of a portion of this work to our staff. For the second quarter of 2004, total CGS increased $14.4 million to $17.0 million from $2.6 million for the comparable period of 2003. As a percentage of total revenues, total CGS was approximately 82.7% for the second quarter of 2004 as compared to 63.1% for the comparable period in 2003. For services and products revenue, CGS was 76.1% for the second quarter of 2004 as compared to 63.1% for the comparable period in 2003. For purchased hardware revenues, CGS was 98.4% and 98.6% in the first six months and second quarter of 2004, respectively, and there were no comparable purchases in the first six months and second quarter of 2003. These second quarter results also reflect the higher volume and increased subcontractor and purchased hardware components discussed above.

Overall margins increased from the end of first quarter of 2004 to the end of second quarter of 2004 from 15.8% to 16.7% due to a change in the mix of products and services provided with an increase in our higher margin services revenue relative to our purchased hardware revenue.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Selling, general and administrative expenses (SG&A) increased $2.5 million to $4.5 million for the first six months of 2004 from $2.0 million for the comparable period in 2003. For the second quarter of 2004, SG&A increased $1.5 million to $2.7 million from $1.2 million for the comparable period in 2003. SG&A has increased to support the higher volume of business as well as including the SG&A of the acquired businesses. SG&A has decreased as a percentage of revenues.

RESEARCH AND DEVELOPMENT EXPENSES. Research and development (R&D) expenses increased $221,000 to $447,000 in the first six months of 2004 compared to $226,000 in the comparable period in 2003. For the second quarter of 2004, R&D increased $213,000 to $307,000 compared to $94,000 in the comparable period in 2003. The Company incurred the majority of its research and development on efforts related to optical communications technology and had incurred R&D since May 2004 in the newly-acquired CSI operation.

AMORTIZATION OF OTHER INTANGIBLE ASSETS. During the first six months of 2004, amortization of other intangible assets was $162,000, which was primarily related to the CSI acquisition. There was $174,000 of amortization costs in the comparable period in 2003 relating to the SDL acquisition. For the second quarters of 2004 and 2003, amortization was $127,000 and $128,000, respectively. The amortization of other intangibles related to the SDL acquisition was substantially complete in the first quarter of 2004.

NET INTEREST INCOME (EXPENSE). Net interest income was $125,000 in the first six months of 2004 compared to net interest expense of $43,000 in the comparable period in 2003. For the second quarter of 2004, net interest income was $49,000 compared to net interest expense of $28,000 in the comparable period in 2003. The net interest income reflects the temporary investment of the proceeds from the stock offering.

NET INCOME. The Company recorded net income of $480,000 and $75,000 in the second quarters of 2004 and 2003, respectively. Net income was $792,000 and $54,000 in the first six month periods of 2004 and 2003, respectively. The Company is in a net operating loss carryforward position for book and tax purposes. No provision for or benefit from income taxes was recognized in the first six months of 2004 or 2003 due to the net operating loss carryforwards. We adjusted our income tax valuation reserves accordingly during these periods.

BACKLOG

As of June 27, 2004, the Company had total contract backlog, funded and unfunded, of approximately $92.0 million as compared with $112.8 million at December 28, 2003. Of these amounts, funded backlog was $31.2 million and unfunded backlog was $60.8 million at June 27, 2004 compared to $15.0 million and $97.8 million, respectively, at fiscal year end 2003. Of the unfunded backlog at June 27, 2004, approximately $18.4 million represents the remaining balance of a $25.0 million U.S. Government Indefinite Delivery Indefinite Quantity, or IDIQ, contract through May 2007 to provide technology to enhance Department of Defense radar programs. Unfunded backlog as of June 27, 2004 also includes the remaining balance of approximately $23.5 million on our $30 million, ten-year contract through 2011 to provide communications systems support to the intelligence community. Unfunded backlog at June 27, 2004 also includes the remaining balance of approximately $14.8 million on our $57.1 million multi-year contract for software and systems engineering that we received in October 2003. Funded backlog generally consists of the sum of all contract amounts of work for which funding has been approved and contracts signed, less the value of work performed under such contracts.

FINANCIAL CONDITION - LIQUIDITY AND CAPITAL RESOURCES

Our primary liquidity and capital resource needs are to finance the costs of our operations including research and development, to make capital expenditures, and to finance acquisitions. Based upon our current level of operations, we expect that our cash flow from operations and amounts of cash on hand will be adequate to meet our anticipated needs for the foreseeable future.

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The Company evaluates its liquidity position using various factors. The following represents some of the more important factors:

	SELECTED FINANCIAL DATA AS OF (In thousands)		
	June 27, 2004	December 28, 2003	June 29, 2003
Total Assets	$ 47,675	$ 39,726	$ 7,911
Working Capital	$ 22,800	$ 32,971	$ 1,123
Current Ratio	3.63:1	12.06:1	1.40:1
Advance from Accounts Receivable Financing	$ --	$ --	$ 472
Capital Leases	47	4	18
Convertible Debt	--	--	500
Other Debt	--	100	100
Total Debt/Financing	$ 47	$ 104	$ 1,090
Shareholders' Equity	$ 38,986	$ 36,745	$ 4,484

During the first six months of 2004, net cash used in operating activities was $2.5 million. Cash provided from net income and non cash depreciation, amortization and other charges of approximately $1.2 million was offset by an increase in accounts receivable and prepaids net of the change in accounts payable and accrued items of $3.7 million. The increase in accounts receivable during the first six months of 2004 was due to the increase in sales and does not reflect any significant change in payment cycle. Payments of $3.9 million were received within 9 days after the end of the second quarter of 2004 on our largest program. Also, accounts receivable at the end of the second quarter includes $1.5 million of receivables purchased from an acquisition.

During the first six months of 2004, net cash used in investing activities was $14.7 million, of which $14.2 million was for the acquisitions of CSI and substantially all of the assets of PGI. The Company also expended $479,000 for property, equipment and leaseholds improvements to support our growing work force. The Company's working capital at June 27, 2004 decreased to $22.8 million from $33.0 million at fiscal year end 2003. The decrease was primarily a result of the acquisitions of CSI and assets of PGI for cash.

During the first six month period of fiscal 2004, net cash provided by financing activities of $1.3 million resulted primarily from the sale of common stock and proceeds from exercises of stock options. (See Note 3 - Common Stock.)

The Company expects to satisfy its operating cash requirements for the remainder of 2004 from its existing cash balance.

INFLATION

Because of the Company's substantial activities in professional services and product development, the Company is more labor intensive than firms involved primarily in industrial activities. To attract and maintain higher caliber professional staff, the Company must structure its compensation programs competitively. The wage demand effect of inflation is felt almost immediately in the Company's costs; however, the net effect during the periods presented is minimal.

The inflation rate in the United States generally has little impact on the Company's cost-reimbursable type contracts and other short-term contracts. For longer-term, fixed-price and time and material type contracts, the Company endeavors to protect its margins by including cost escalation provisions or other specific inflation protective terms in these contracts.

THE PRECEDING PARAGRAPHS DISCUSSING THE COMPANY'S FINANCIAL CONDITION CONTAIN FORWARD-LOOKING STATEMENTS. THE FACTORS AFFECTING THE ABILITY OF THE COMPANY TO MEET ITS FUNDING REQUIREMENTS AND MANAGE ITS CASH RESOURCES INCLUDE, AMONG OTHER THINGS, THE AMOUNT AND TIMING OF PRODUCT SALES, INVENTORY TURNOVER, THE MAGNITUDE OF FIXED COSTS, SALES GROWTH AND THE ABILITY TO OBTAIN WORKING CAPITAL, ALL OF WHICH INVOLVE RISKS AND UNCERTAINTIES THAT ARE DIFFICULT TO PREDICT.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company had no debt outstanding as of June 27, 2004.

ITEM 4. CONTROLS AND PROCEDURES

Based on their most recent evaluation, Leonard E. Moodispaw, the Company's Chief Executive Officer and Lisa G. Jacobson, the Company's Chief Financial Officer, have concluded that the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) as of the end of the period covered by this report are effective to ensure that information required to be disclosed by the Company in this report is accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate, to be recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission's rules and forms.

There were no significant changes in the Company's internal controls or other factors that materially affected, or are reasonably likely to materially affect, these controls subsequent to the date of their evaluation and there were no corrective actions with regard to significant deficiencies and material weaknesses.

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PART II - OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

Exhibit 31.1 - Certification by the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 31.2 - Certification by the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 32.1 - Certification by the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350 Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 *

Exhibit 32.2 - Certification by the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 *

*These exhibits are being "furnished" with this periodic report and are not deemed "filed" with the Securities and Exchange Commission and are not incorporated by reference in any filing of the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation by reference language in any such filing.

(b) Reports on Form 8-K

(1) Form 8-K dated March 29, 2004 filing of Company's press release which announced that trading of shares of common stock of Essex Corporation will move to the NASDAQ National Market upon market opening on Wednesday March, 31, 2004 under the symbol "KEYW".

(2) Form 8-K dated April 21, 2004, filing of Company's press release which announced that it has entered into an exclusive Letter of Intent to acquire Computer Science Innovations ("CSI") of Melbourne, Florida.

(3) Form 8-K dated April 26, 2004 filing of Company's press release which announced the appointment of Dr. Anthony

Johnson as an independent director on Essex's Board of Directors and that Mr. Frank Manning has retired from the Board. Mr. Manning, the founder of Essex Corporation, retains his position as Chairman Emeritus of Essex.

(4) Form 8-K dated April 28, 2004 filing of Company's press release which announced the Merger by and among the Registrant, its wholly-owned subsidiary ("Merger Sub"), Computer Science Innovations, Inc., a Florida corporation ("CSI"), and Computer Science Innovations Employee Stock Ownership Plan, Merger Sub was merged with and into CSI with CSI as the surviving corporation (the "Merger"). The Merger became effective as of April 30, 2004.

(5) Form 8-K dated May 4, 2004 filing of Company's press release which announced the Corporation's financial results for the three months ended March 28, 2004.

(6) Form 8-K dated June 7, 2004 filing of the Company's press release which announced that it has entered into a definitive agreement to acquire substantially all of the assets of Performance Group, Inc. ("PGI") of Fredericksburg, Virginia.

(7) Form 8-K/A dated June 25, 2004 filing of the Computer Science Innovations, Inc. Financial Statements for the years ended March 31, 2004 and 2003, together with Auditors' Report and Pro Forma Financial Information (unaudited).

SIGNATURES

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.

ESSEX CORPORATION
(Registrant)

Date: August 10, 2004

/S/ LISA G. JACOBSON

Lisa G. Jacobson
Executive Vice President and Chief Financial Officer

(Ms. Jacobson is the Principal Financial and Chief Accounting Officer of the Registrant and has been duly authorized to sign on behalf of the Registrant.)