HALIFAX CORP
Form 10-K
June 23, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K

(Mark One)

þ **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the fiscal year ended March 31, 2006 or

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from __________ to __________

Commission file Number 1-08964
Halifax Corporation
(Exact name of registrant as specified in its charter)

Virginia	**54-0829246**
(State or other jurisdiction of incorporation of organization)	(IRS Employer Identification No.)
5250 Cherokee Avenue, Alexandria, VA	**22312**
(Address of principal executive offices)	(zip code)

Registrant s telephone number, including area code **(703) 750-2400**
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock ($.24 par value)	**American Stock Exchange**

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

Indicate by check mark if the registrant is a well- known seasoned issuer, as defined in Rule 405 of the Securities Act. o Yes þ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. o Yes þ No

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. þYes oNo

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

Indicate by check mark whether the registrant is a larger accelerated filer, an accelerated filer, or non-accelerated filer See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Act. o Larger accelerated filer o Accelerated filer þ Non-accelerated filer

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of September 30, 2005 was $8,787,045 computed based on the closing price for that date.

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

Class	Outstanding at June 10,2006
Common Stock $0.24 par value	3,172,206

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement of the registrant for the registrant s 2006 Annual Meeting of Shareholders, which definitive proxy statement will be filed with the Securities and Exchange Commission not later than 120 days after the registrant s fiscal year ended March 31, 2006, are incorporated by reference into Part III. Notwithstanding such incorporation, the Audit Committee Report, Compensation Committee Report and the graph showing performance of our stock and other information in the 2006 Proxy Statement that is not required to be included in Part III shall not be deemed to be incorporated by reference into or filed as part of this report.

TABLE OF CONTENTS

PART I

Forward Looking Statements

Certain statements in this Annual Report on Form 10-K constitute forward-looking statements within the meaning of the Federal Private Securities Litigation Reform Act of 1995. While forward-looking statements sometimes are presented with numerical specificity, they are based on various assumptions made by management regarding future events over which we have little or no control. Forward-looking statements may be identified by words including anticipate, believe, estimate, expect and similar expressions. We caution readers that forward-looking statements, including without limitation, those relating to future business prospects, revenues, working capital, liquidity, and income, are subject to certain risks and uncertainties that would cause actual results to differ materially from those indicated in the forward-looking statements. Factors that could cause actual results to differ from forward-looking statements include the concentration of our revenues, risks involved in contracting with our customers, including the difficulty to accurately estimate costs when bidding on a contract and the occurrence of start-up costs prior to receiving revenues and contracts with fixed price provisions, potential conflicts of interest, difficulties we may have in attracting and retaining management, professional and administrative staff, fluctuation in quarterly results, our ability to generate new business, our ability to maintain an effective system of internal controls, risks related to acquisitions and our acquisition strategy, continued favorable banking relationships, the availability of capital to finance operations and planned growth and ability to make payments on outstanding indebtedness, weakened economic conditions, reduced end-user purchases relative to expectations, pricing pressures, excess and obsolete inventory, acts of terrorism, energy prices, risks related to competition and our ability to continue to perform efficiently on contracts, and other risks and factors identified from time to time in the reports we file with the SEC. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated or projected.

Forward-looking statements are intended to apply only at the time they are made. Moreover, whether or not stated in connection with a forward-looking statement, we undertake no obligation to correct or update a forward-looking statement should we later become aware that it is not likely to be achieved. If we were to update or correct a forward-looking statement, investors and others should not conclude that we will make additional updates or corrections thereafter.

All references to we, our, us, the Company, or Halifax refer, on a consolidated basis to Halifax Corporation unless otherwise indicated.

Item 1. Business

Halifax Corporation headquartered in Alexandria, Virginia provides a comprehensive range of enterprise maintenance services, and solutions to a broad base of clients throughout the United States and prior to June 30, 2005, we also provided secured network services to the Department of Defense, referred to as DOD and the intelligence community. On June 30, 2005, we sold our secure networks services business to enable us to focus our resources on our core business of high availability enterprise maintenance services and technology deployment and integration services. We provide 7x24x365 technology solutions that can meet stringent enterprise service requirements. For more than 37 years, we have been known for quality and reliability in service delivery to our customers.

Sale of Secure Network Services Business

On June 30, 2005, the Company simultaneously entered into and closed on an asset purchase agreement with INDUS Corporation pursuant to which it sold substantially all of the assets and certain liabilities of its secure network services business. The purchase price was approximately $12.5 million, in addition to adjustments for working capital of approximately of $608,000 for total consideration approximately $13.1 million. The asset purchase agreement provided that $3.0 million of the purchase price was to be held in escrow to serve as security to obtain certain consents, novations and indemnification obligations. On July 8, 2005, the $1.0 million held in escrow to serve as security to obtain certain consents was released to the Company. Certain other novations and consents required under the asset purchase agreement were received and, on January 26, 2006, $1.375 million plus accrued interest of $24,000 was paid and released to the Company. Accordingly, $625,000 of the original escrow amount remains in escrow as security for the payment of the Company s indemnification obligations pursuant to the asset purchase agreement. If there are no such obligations, these funds will be released to the Company eighteen (18) months following the date of closing, or December 30, 2006.

The asset purchase agreement contains representations, warranties, covenants and related indemnification provisions, in each case that are customary in connection with a transaction of this type; however, certain of the representations and warranties required updating to a date which is the earlier of the contract novation or thirty months from the closing. In addition, survival periods applicable to such updated warranties may be extended together with related indemnification periods. As of March 31, 2006 the Company is not aware of any claims associated with the remaining escrow. See Management s Discussion and Analysis of Financial Condition and Results of Operations Sale of Secure Network Services Business. The secure network services business comprised approximately $13.6 million, or 22%, and $9.5 million, or 19%, of our revenues for the fiscal years ended 2005 and 2004 and represented 9% of the Company s assets at March 31, 2005.

As a result of receiving notification that the key contract had been novated, the Company recorded a gain on the sale of the secure network services business after taxes, fees and costs of approximately $5.7 million (net of income taxes of approximately $3.6 million). As a result of the sale of the secure network services business, the Company utilized a portion of its net operating loss carryforward in fiscal year ending March 31, 2006 and has reduced its deferred tax asset accordingly.

As a result of the sale of the secure network services business, our results of operations and related assets and liabilities have been classified as discontinued operations for all periods presented.

Our Business

We are a nation-wide, high-availability, multi-vendor enterprise maintenance services and solutions provider for enterprises, including businesses, global service providers, governmental agencies and other organizations.

Our principal services are high availability hardware maintenance services and technology deployment and integration. Prior to June 30, 2005 our principal services also included secure network services.

We were incorporated in 1967 under the laws of the Commonwealth of Virginia. We maintain our principal executive offices at Halifax Office Park, 5250 Cherokee Avenue, Alexandria, Virginia 22312. Our telephone number is (703) 750-2400, and our website is www.hxcorp.com. We make available free of charge on www.hxcorp.com a link to our annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, on the SEC s website. The information on the website listed above is not and should not be considered part of this Form10-K and is not incorporated by reference in this document. This website is and only is intended to be an active textual reference.

Our strategy is to build our position as an innovative leader in the high availability enterprise maintenance solutions marketplace. We currently have the following key business focuses:

- High Availability Maintenance Services- 7 days a week, 24 hours a day, 365 days a year, multi-vendor support for nationwide customers with demanding service level requirements
- Technology Deployment and Integration Services- nationwide deployment and integration support services.

High Availability Maintenance Services

We provide our clients with a comprehensive high availability enterprise maintenance solution through a single point of contact. Our service offerings include high availability enterprise maintenance services customized to specific customer needs for 7 days per week, 24 hours per day, 365 days per year (7x24x365) support on a nationwide basis, life cycle management of client desktop environment and equipment, moves and changes, and providing personnel with security clearances to support certain governmental agencies. Clients are offered a unique mix of nationwide coverage, multi-vendor and multi-system support, project management expertise, and customized service programs. The result is a customized solution that meets our customers enterprise maintenance requirements while reducing their costs.

We provide our maintenance services to over 25,000 locations and more than 350,000 units of equipment through a wide variety of custom designed programs. A 7x24x365 dispatch center, a state-of-the-art depot repair facility, inventory warehouses and a technical support staff supports our enterprise maintenance clients. Halifax is an authorized service provider for many major manufacturers, including International Business Machines, Hewlett Packard, Dell, Gateway and Lexmark.

Halifax works closely with each client to develop and implement the service program needed to achieve its business objectives. We draw from a wide range of services expertise and an established corporate technology base to deliver customized, results-driven enterprise maintenance solutions.

Technology Deployment and Integration Services

We provide technology deployment and integration services through several of our alliance partners and certain direct customers. At present, our principal service offering is seat management, which is a highly customizable and comprehensive service that encompasses the management, operation, and maintenance of an organization s desktops, servers, communications, printers, peripherals and associated network infrastructure and components. This service transfers complete PC desktop responsibility along with all associated services from the client to us. In return, the organization is afforded a full spectrum of computing resources for a fixed price per seat through a single ordering process.

Our seat management services provide each client with a business solution that is flexible enough to suit the unique requirements of the organization, while still offering the client absolute control over their IT environment by defining the level of service required to support the end users and the client s missions.

Our seat management services provide numerous tangible benefits that can have an immediate impact on an organization. These benefits include the ability to:

- Reduce our clients total cost of ownership;
- Improve service levels and response times;
- Reduce the administrative costs for procurement;
- Increase user productivity through decreased downtime;
- Amortize costs across thousands of users;
- Focus IT staff on core responsibilities;
- Eliminate the time and expense of storage, sale, and disposal of surplus equipment;
- Simplify accounting with one report, one invoice, and one charge per user; and
- Create a single source of accountability for all PC desktop hardware, software, and services.

Secure Network Services

Prior to June 30, 2005, we served the needs of various sectors of the Federal government related to communication services in voice, data, and video primarily for secure environments. We provided installation, engineering, maintenance and logistics support for our clients projects. Our principal customers included the DOD and U.S. Army and the intelligence community. Orders were typically placed with us using multi-task support contracts. We also provided these services on a subcontract basis to several system integrators for the federal marketplace.

Our highly trained communications professionals were experienced in the installation of local area networks and wide area networks. Most of these communications professionals had current/active security clearances with major federal agencies.

Acquisitions

Purchase of Contract

On December 1, 2005, we purchased a services contract for $330,000 from Technical Services and Support, Inc., (TSSI) In addition, we hired certain employees and subcontractors of TSSI. The contract has a term of fifty-four months. The contract rights will be amortized over the remaining life of the contract of fifty-four months.

On September 30, 2004, we acquired 100% of the outstanding capital stock of AlphaNational Technology Services, Inc., referred to as AlphaNational, in a merger transaction, for total consideration of approximately $2.4 million. We acquired AlphaNational to increase our geographic coverage, expand the depth of management and increase the breadth of our product serviceability. AlphaNational is an enterprise maintenance solutions company providing services to a national market place.

On August 29, 2003, we completed the acquisition of Microserv, Inc., an enterprise maintenance solutions company located in Seattle, Washington. The acquisition expanded our geographic base and strengthened our nationwide service delivery capabilities, as well as added a number of prestigious customers.

Types of Customers

The following table reflects the distribution of revenues by type of customer (see Management s Discussion and Analysis of Financial Condition and Results of Operations for further discussion):

	Years Ended March 31,					
(Amounts in thousands)	2006		2005		2004	
State/Municipal Government	10,705	19%	$ 9,663	20%	$ 13,039	33%
Commercial	43,383	80%	37,851	78%	26,279	66%
Federal Government	823	1%	912	2%	738	1%
Total	$ 54,911	100%	$ 48,426	100%	$ 40,056	100%

Not included above is revenues associated with the secure network services business, which was sold in June 2005, and comprised approximately $13.6 million, or 22%, of our revenues and $9.5 million, or 19% of our revenues, and $11.4 million, or 22% of our revenues for the fiscal years ended 2005, 2004 and 2003 and is reported as discontinued operations.

A portion of our revenues have historically been derived from contracts and subcontracts with the Federal government. With the sale of our secure network services business as of June 30, 2005, we no longer have the economic benefit of these contracts and subcontracts.

We continue to work towards expanding our commercial and state/municipal government business. Commercial revenues are being pursued by targeting non-federal and IT outsourcing opportunities. State/municipal government contracts may increase as a result of privatization opportunities.

Types of Contracts

We perform services under time-and-material, fixed unit-price, subcontracts, and General Services Administration, or GSA, schedule contracts. For time-and-material contracts, we receive a fixed hourly rate intended to cover salary costs attributable to work performed on the contracts and related indirect expenses, as well as a profit margin, and reimbursement for other direct costs. Under fixed unit-price contracts, we are paid an agreed-upon price per unit for services rendered. Under fixed unit-price contracts and time-and-material contracts, we bear any risk of increased or unexpected costs that may reduce our profits or cause us to sustain losses. When we are selected under a GSA schedule contract to provide products or services, revenues are recognized upon delivery of the product or services. Presently, our sales under the GSA contract are limited to product sales, where the risks related to unexpected costs increases do not exist.

For the three years ended March 31, 2006, 2005 and 2004, approximately 90%, of our revenues received were from fixed unit-price revenues contracts.

Prior to June 30, 2005, revenue derived from these Federal government contracts were performed under indefinite delivery/indefinite quantity contracts.

Historically, our Federal and state government, and local contracts and subcontracts were subject to termination, reduction or modification as a result of changes in the government s requirements or budgetary restrictions. A portion of our sales to the government are made indirectly as a subcontractor to another government contractor, referred to as the prime contractor, who has the direct relationship with the government. We also may team with prime contractors to bid on competitive government opportunities for which we would serve as a subcontractor. If prime contractors were to lose business on which we may serve as a subcontractor, or fail to win the competitive bids on which we teamed with them, our government business would be adversely impacted.

We are sensitive to the present climate in the government with respect to fraud, waste and abuse, and had adopted a Code of Business Ethics and Standards of Conduct and associated procedures. In addition, all employees receive training in business ethics and associated procedures, and a hotline had been established to encourage reporting of potential ethical violations.

As a result of the sale of our secure network services business which was completed on June 30, 2005, we no longer have any of the economic benefit of Federal government contracts regarding secure network services. Presently, our Federal government activity is limited to activities under our GSA schedule.

Our primary offices include locations in:

- Alexandria, Virginia;
- Harrisburg, Pennsylvania;
- Richmond, Virginia;
- Trenton, New Jersey;
- Charleston, South Carolina;
- Seattle, Washington; and
- Ft. Worth, Texas.

Prior to June 30, 2005, we also maintained an office in Frederick, Maryland.

Accounts Receivable

Trade accounts receivable at March 31, 2006 and 2005 represented 42% and 29% of total assets, respectively. Accounts receivable are comprised of billed and unbilled receivables. Billed receivables represent invoices presented to the customer. Unbilled receivables represent revenues earned with future payments due from the customer for which invoices will not be presented until a later period.

Backlog

Our funded backlog for services as of March 31, 2006 was $60.7 million. Of the $60.7 million of backlog at March 31, 2006, approximately 50% is expected to be recognized during fiscal year 2007. Funded backlog represents commercial orders and government contracts to the extent that funds have been appropriated by and allotted to the contract by the procuring entity, some of which may span multiple years. Some of our contract orders provide for potential funding in excess of the monies initially provided by the government. Additional monies are subsequently and periodically authorized in the form of incremental funding documents. The excess of potential future funding over funding provided represents unfunded backlog. A majority of our customer orders or contract awards and extensions for contracts previously awarded are received or occur at various times during the year and may have varying periods of performance.

Selling

Our direct sales and marketing organization is focused on delivering additional services and solutions to our targeted markets and current client base. Our marketing efforts have focused on increasing brand awareness, enhancing bid and proposal capabilities, producing targeted sales aids, identifying high potential sales leads, and engaging in other public relations activities.

We deliver services and solutions through a variety of distribution channels. We have developed strong partnership alliances with certain global services providers, OEM s and system integrators. We have also developed several direct relationships with commercial, federal, state and local customers.

Competition

We have numerous competitors in our marketplace. Some competitors are large diversified firms having substantially greater financial resources and a larger technical staff than ours, including, in some cases, the manufacturers of the systems being supported, and others are small companies within a regional market or market niche. Customer in-house capabilities can also create competition in that they perform certain services which might otherwise be performed by us. It is not possible to predict the extent of competition which our present or future activities will encounter because of changing competitive conditions, customer requirements, technological developments and other factors. The principal competitive factors for the type of service business in which we are engaged are technology skills, quality, pricing, responsiveness and the ability to perform within estimated time and expense guidelines.

We believe we are most competitive where the customer is geographically dispersed throughout the U.S. and demands high service attainment levels.

Personnel

On March 31, 2006, we had 520 employees, of whom 72 were part-time and 12 were temporary employees. Because of the nature of our services, many employees are professional or technical personnel with high levels of training and skills, including engineers, skilled technicians and mechanics. We believe our employee relations are excellent. Although many of our personnel are highly specialized, we have not experienced material difficulties obtaining the personnel required to perform under our contracts and generally do not bid on contracts where difficulty may be encountered in providing these necessary services. Management believes that the future growth and our success will depend, in part, upon our continued ability to retain and attract highly qualified personnel.

Item 1A Risk Factors

Investing in our common stock involves risks. You should carefully consider all of the information contained in this Annual Report on Form 10-Ks and, in particular, the risks described below. Additional risks and uncertainties not presently known to us or those we currently deem immaterial may impair our business operations in the future. If any of the following risks actually occur, our business, financial condition or results of operations could be materially harmed and you may lose part or all of your investment.

We experienced a loss from continuing operations of $4.5 million in fiscal 2006, and continued losses may negatively impact our financial position and value of our common stock.

We incurred a loss from continuing operations in fiscal 2006 of $4.5 million. The primary reasons for the loss from continuing operations in fiscal 2006 were a charge for impairment of goodwill and expenses associated with a long-term, nationwide, enterprise maintenance contract which terminated on April 30, 2006. In addition, we may not be able to generate sufficient new business to replace the contribution margins derived from the contracts sold in connection with the sale of our secure network services business sold on June 30, 2005, contain costs to a reduced level or expand our existing business in order to regain profitable operations. Although we reported net income for the year ended March 31, 2006, the net income was the result of gain on the sale of our secure network services business on June 30, 2005.

We will continue to incur expenses in operating our business. As we focus on our core business, there are no assurances that our cost containment efforts will be successful in curbing expenses or that we will be able to accurately estimate start-up costs and expenses associated with new contracts. If we incur expenses at a greater pace than our revenues, we could incur additional losses. If we continue to experience losses, our financial position could be negatively impacted and the value of our common stock may decline.

Our revenues are derived from a few major customers, the loss of any of which could cause our results of operations to be adversely affected.

We have a number of major customers. Our largest customer accounted for 20%, 20%, and 22% of our revenues for the fiscal years ended March 31, 2006, 2005 and 2004, respectively. Through the aggregation of multiple contracts, our largest customer during fiscal year ended March 31, 2006 was IBM. Our five largest customers collectively accounted for 54%, 65% and 67% of revenues for the fiscal years ended March 31, 2006, 2005 and 2004, respectively. As of June 30, 2005, as a result of the sale of our secure network services business, we no longer have the economic benefit of any material contracts or subcontracts providing services to the Federal government. We anticipate that significant customer concentration will continue for the foreseeable future, although the companies which constitute our largest customers may change from period to period. Factors beyond our control, including political, state and federal budget issues, competitor prices and other factors may have an impact on our ability to retain contracts. The loss of any one or more of these customers may adversely affect our results. As a result of the sale of our secure network services business, there can be no assurances that we can replace the revenue stream from our secure network services business with other new business.

If we experience a decline in cash flow or are unable to maintain compliance with the covenants contained in our revolving credit facility, our ability to operate could be adversely affected.

If either cash flow from operations decline in value or borrowings under our revolving credit agreement are insufficient to meet our needs, our ability to operate could be adversely affected. In addition, the loss of a significant contract, adverse economic conditions or other adverse circumstances may cause our capital resources to change dramatically. Operating results may also be negatively affected due to costs associated with starting a major contract. Many costs associated with starting a new contract, such as hiring additional personnel, training, travel and logistics are expensed as incurred and may also significantly impact cash flow during the startup period. Additional funds, if needed, to help fund start-up costs related to a major new contract may not be available. We view our revolving credit facility as a critical source of available liquidity. This facility contains various conditions, covenants and representations with which we must be in compliance in order to borrow funds. We were not in compliance with the terms of our revolving credit facility at December 31, 2004 and March 31, 2005 as we failed to meet certain financial covenants. In both instances we requested and received waivers from our lender. On June 29, 2005 our revolving credit agreement was amended to adjust the covenants prospectively and to extend the maturity of the agreement to June 30, 2007. At March 31, 2006, we were in compliance with these financial covenants. There is no assurance that we will remain in compliance with the conditions, covenants and representations contained in the revolving credit agreement. Although we believe our relationship with our lender is satisfactory and we have requested and received waivers in the past for non-compliance with the financial covenants of our revolving credit agreement, there are no assurances that the lender will waive these covenants should we experience non-compliance in the future.

We operate in a highly competitive market. If we are unable to offer competitive products and services, our business may be adversely affected.

We have numerous competitors in our marketplace. Some competitors are large diversified firms having substantially greater financial resources and a larger technical staff than us, including, in some cases, the manufacturers of the systems being supported, and others are small companies within a regional market or market niche. Customer in-house capabilities can also create competition in that they perform certain services which might otherwise be performed by us. It is not possible to predict the extent of competition which our present or future activities will encounter because of changing competitive conditions, customer requirements, technological developments and other factors.

The industry in which we operate has been characterized by rapid technological advances that have resulted in frequent introductions of new products, product enhancements and aggressive pricing practices, which also impacts pricing of service activities. We continue to see significant price competition and customer demand for higher service attainment levels. In addition, there is significant price competition in the market for state and local government contracts as a result of budget issues, political pressure and other factors beyond our control. As experienced with losses of some of our contracts, high quality and longevity of service may have little influence in the customer decision making process. Also, our operating results could be adversely impacted should we be unable to achieve the revenues growth necessary to provide profitable operating margins in various operations.

Our operating results may be adversely affected because of pricing pressures brought about by competition, proprietary technology that we are unable to support, presence of competitors with greater financial and other resources or other factors beyond our control.

Our revenues and results of operations may vary period to period, which may cause the common stock price to fluctuate.

Our quarterly and annual revenues and results of operations may vary significantly in the future due to a number of factors, which could cause the common stock price to fluctuate greatly. Factors that may affect our quarterly and annual results include but are not limited to:

- changes in economic conditions;
- disruptions or downturns in general economic activity resulting from terrorist activity and armed conflict;
- competitive pricing pressure;
- lengthening sales cycles;
- obsolescence of technology;
- increases in prices of components used to support our enterprise maintenance solutions;
- loss of material contracts; and
- the success of our business strategy in providing improved operating results.

Unfavorable economic conditions and additional costs associated with a new long-term nationwide enterprise maintenance contract have adversely affected our results of operations and led to a decline in our growth rates. We incurred a loss from continuing operations of $4.5 million for the fiscal year ended March 31, 2006, which includes the effect of additional costs from this contract as well as a goodwill impairment charge of $3.2 million. This contract was terminated on April 30, 2006.

Our business was also negatively affected by the economic slowdown and reductions in spending by our customers in 2006 and 2005. The rate at which the portions of our industry improve is critical to our overall performance.

Many of our services are sold as part of a larger technology outsourcing solution. In the past, we have experienced historical growth in our business as we have assumed responsibility for maintaining our customers IT infrastructure. The demand for these services has been adversely affected by the effects of a weakened economy in recent periods with many businesses focusing on cost containment strategies and eliminating or curtailing maintenance.

Although revenues increased in the fiscal year ended March 31, 2006, we have been unable to replace the contracts lost in connection with the sale of our secured networks services business which was completed on June 30, 2005 with a sufficient number of new contracts. As a result, there can be no assurances that either our revenues will increase over time or that we will be able to return to profitable operations.

We depend on recurring long-term contracts for services from a limited number of large original equipment manufacturers, or OEMs, partners and end users. Our agreements with OEMs are in the form of master service agreements and are typically cancelable, non-exclusive and have no minimum purchase requirements.

Factors beyond our control, including political, state and federal budget issues, price and other factors may have an impact on our ability to successfully retain contracts.

If we are unable to generate sufficient revenues, we may have to further down size.

On June 30, 2005, we sold our secure network services business. For the fiscal years ended March 31, 2005 and 2004 the secure network services business generated revenues of $13.6 million and $9.4 million, respectively. Contribution to overhead of this business was $2.2 million and $1.2 million for fiscal years 2005 and 2004. If we are unable to generate sufficient new business to replace the business sold, we may be forced to consolidate our operations to reduce operating expense sufficiently to regain profitable operations. There can be no assurances that we will be able to generate sufficient new business or that our cost containment measures in place will provide us the ability to regain profitability in the future.

If we are unable to retain and attract highly qualified personnel to fulfill our contract obligations, our business may be harmed.

Our most important resource is our employees. Although many of our personnel are highly specialized, we have not experienced material difficulties obtaining the personnel required to perform under our contracts and generally do not bid on contracts where difficulty may be encountered in providing these necessary services. There can be no assurance that we will not experience difficulties in the future obtaining the personnel necessary to fulfill our obligations under our contracts.

We are subject to risks related to fluctuations in interest rates.

We are exposed to changes in interest rates, primarily as a result of using borrowed funds to finance our business. The floating interest debt exposes us to interest rate risk, with the primary interest rate exposure resulting from changes in the prime rate. Adverse changes in the interest rates or our inability to refinance our long-term obligations may have a material negative impact on our results of operations and financial condition.

We incur significant costs in connection with the start-up of new contracts before receiving related revenues, which could result in cash shortfalls and fluctuations in quarterly results from period to period.

When we are awarded a contract to provide services, we may incur expenses before we receive any contract payments. These expenses include purchasing equipment and hiring personnel. For example, contracts may not fund program start-up costs and we may be required to invest significant sums of money before receiving related contract payments. Additionally, any resulting cash shortfall could be exacerbated if we fail to either invoice the customer or to collect fees in a timely manner. A cash shortfall could result in significant consequences. For example, it:

- could increase our vulnerability to general adverse economic and industry conditions;

- will require us to dedicate a substantial portion of our cash flow from operations to service payments on its indebtedness; reducing the availability of our cash flow to fund future capital expenditures, working capital, execution of its growth strategy, research and development costs and other general corporate requirements;

- could limit our flexibility in planning for, or reacting to, changes in its business and industry, which may place us at a competitive disadvantage compared with competitors; and

- could limit our ability to borrow additional funds, even when necessary to maintain adequate liquidity.

As a result, there are no assurances that additional funds, if needed, to help fund start-up costs related to a major new contract would be available or, if available on terms advantageous to us.

Some of our contracts contain fixed-price provisions that could result in decreased profits if we fail to accurately estimate our costs.

Some of our contracts contain pricing provisions that require the payment of a set fee by the customer for our services regardless of the costs we incur in performing these services. In such situations, we are exposed to the risk that it will incur significant unforeseen costs in performing the contract. Therefore, the financial success of a fixed-price contract is dependent upon the accuracy of our cost estimates made during contract negotiations. Prior to bidding on a fixed-price contract, we attempt to factor in variables including equipment costs, labor and related expenses over the term of the contract. However, it is difficult to predict future costs, especially for contract terms that range from 3 to 5 years. Any shortfalls resulting from the risks associated with fixed-price contracts will reduce our working capital and profitability. Our inability to accurately estimate the cost of providing services under these contracts could have an adverse effect on our profitability and cash flows. One of the factors contributing to the loss from continuing operations we incurred for the year ended March 31, 2006, on long-term nationwide enterprise maintenance contract, was underestimating failure rates on certain pieces of equipment, which resulted in increased parts and labor cost and not anticipating certain service costs. These costs were comprised of procurement and consumption of inventory, freight costs, increases in overtime and higher than anticipated usage of subcontractors. This contract was terminated on April 30, 2006.

If we are unable to effectively and efficiently reduce costs and replace the revenues lost as a result of the sale of our secure network services business, our results of operations may be adversely affected.

We have taken, and continue to take, cost reduction actions. Our ability to complete these actions and the impact of such actions on our business may be limited by a variety of factors. The cost reduction actions may in turn expose us to additional service delivery risks and have an adverse impact on our sales and profitability. We have been reducing costs and streamlining our business process throughout our organization. We have reduced our physical facilities, reduced our employee population, improved our repair facilities, and reduced other costs. The impact of these cost-reduction actions on our revenues and profitability may be influenced by factors including, but not limited to:

- our ability to complete these on-going efforts,
- our ability to generate the level of savings we expect and/or that are necessary to enable us to effectively compete,
- decrease in employee personnel,
- ability to generate sufficient revenue and or reduce operating expenses to offset the contribution that was generated from the secure network services business which was sold on June 30, 2005, and
- the performance of other parties under arrangements on which we rely to support parts or components.

If we fail to maintain an effective system of internal controls, we may not be able to accurately report our financial results or prevent fraud. As a result, current and potential stockholders and customers could lose confidence in our financial reporting, which could harm our business, the trading price of our stock and our ability to retain our current customers or obtain new customers.

During fiscal 2005, we began to evaluate our internal controls over financial reporting in order to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act, which requires annual management assessments of the effectiveness of our internal controls over financial reporting and a report by our independent auditors addressing these assessments beginning in fiscal year ending March 31, 2008. In this regard, management will be required to dedicate internal resources to (i) assess and document the adequacy of internal controls over financial reporting, and (ii) take steps to improve control processes, where appropriate. If we fail to correct any issues in the design or operating effectiveness of internal controls over financial reporting or fail to prevent fraud, current and potential stockholders and customers could lose confidence in our financial reporting, which could harm our business, the trading price of our stock and our ability to retain our current customers and obtain new customers.

If we make future acquisitions of companies, technology and other assets that involve numerous risks such as difficulty integrating acquired companies, technologies and assets or generating an acceptable return on its investments.

If we pursue opportunities to acquire companies, technologies and assets that would complement our current service offerings, expand the breadth of its markets, enhance its technical capabilities, or that may otherwise offer growth opportunities as we have done in the past. Acquisitions involve numerous risks, including the following: difficulties in integrating the operations, technologies, products and personnel of the acquired companies;

- diversion of management s attention from normal daily operations of our business;
- difficulties in entering markets in which we have no or limited direct prior experience and where competitors in such markets have stronger market positions;

- initial dependence on unfamiliar supply chains or relatively small supply partners;
- insufficient revenues to offset increased expenses associated with acquisitions; and
- the potential loss of key employees of the acquired companies.

Acquisitions may also cause us to:

- issue common stock or preferred stock or assume stock option plans that would dilute current shareholders percentage ownership;
- use cash, which may result in a reduction of our liquidity;
- assume liabilities;
- record goodwill and non-amortizable intangible assets that would be subject to impairment testing and potential periodic impairment charges;
- incur amortization expenses related to certain intangible assets;
- incur large and immediate write-offs; and
- become subject to litigation.

Mergers and acquisitions of companies in our industry and related industries are inherently risky, and no assurance can be given that our acquisition strategy will be successful, that we will have the resources to pursue this strategy, and will not materially adversely affect its business, operating results, or financial condition. Failure to manage and successfully integrate acquisitions could harm our business and operating results in a material way. Even when an acquired company has already developed and marketed products or services, there can be no assurance that product enhancements will be made in a timely fashion or that all pre-acquisition due diligence will have identified all possible issues that might arise with respect to such products or services.

We do not expect to pay dividends on our common stock.

We have not declared or paid any dividends on our common stock during fiscal 2006, fiscal 2005 or 2004 and do not anticipate paying any cash dividends on our common stock in the foreseeable future.

Shareholders of our common stock may face a lack of liquidity.

Although our common stock is currently traded on the American Stock Exchange, given the fact that our common stock is thinly traded, there can be no assurance that the desirable characteristics of an active trading market for such securities will ever develop or be maintained. Therefore, each investor s ability to control the timing of the liquidation of the investment in our common stock will be restricted and an investor may be required to retain his investment in our common stock indefinitely.

The market price of our common stock has been and is likely to continue to be volatile, which may make it difficult for shareholders to resell common stock when they want to and at prices they find attractive.

Our share price has been volatile due, in part, to the general volatile securities market. Factors other than our operating results may affect our share price may include the level of perceived growth of the industries in which we participate, market expectations of our performance success of the partners, and the sale or purchase of large amounts of our common stock.

Provisions in our corporate charter documents could delay or prevent a change in control.

Our Articles of Incorporation, as amended, and Bylaws contain certain provisions that would make a takeover of our company more difficult. Under our Articles of Incorporation, as amended, we have authorized 1,500,000 shares of preferred stock, which the Board of Directors may issue with terms, rights, preferences and designations as the Board of Directors may determine and without the vote of shareholders, unless otherwise required by law. Currently, there are no shares of preferred stock issued and outstanding. Issuing the preferred stock, depending on the rights, preferences and designations set by the Board of Directors, may delay, deter, or prevent a change in control of us. Issuing additional shares of common stock could result in a dilution of the voting power of the current holders of the common stock. This may tend to perpetuate existing management and place it in a better position to resist changes that the shareholders may want to make if dissatisfied with the conduct of our business.

Item 1B. Unresolved Staff Comments

Not applicable

Item 2. Properties

After giving effect to the sale of the secure network services business as of June 30, 2005, we had obligations under 16 short-term facility leases associated with our operations. Total rent expense under existing leases was $1.3 million, $1.1 million, and $782,000 for the years ended March 31, 2006, 2005 and 2004, respectively. See Note 13 to the Consolidated Financial Statements. Our executive offices are located in Alexandria, VA; with additional locations in Harrisburg, PA; Richmond, VA; Trenton, NJ; Charleston, SC; Ft. Worth, TX, and Seattle, WA. Prior to June 30, 2005 we also had an office in Frederick, Md.

On November 6, 1997, we sold our headquarters office complex for $5.25 million and leased back the building. The transaction generated other income of $1.49 million of which $715,000 was deferred and is being amortized over the 12 year lease-back of our headquarters building. The monthly rent is approximately $48,000.

Item 3. Legal Proceedings

On August 17, 2005, the Company was named as a defendant in a lawsuit filed by BIS Computer Services, Inc. in the United States District Court for the Eastern District of Virginia alleging that the Company breached its contract with BIS Computer Services, Inc., a subcontractor, did not act in good faith, and further did not comply with the terms and conditions of the agreement. The plaintiff sought compensatory damages of approximately $1.6 million and punitive damages of $350,000 as well certain prejudgment and post judgment interest.

On January 27, 2006, the Company was granted a motion for summary judgment and the lawsuit was dismissed. Subsequently, the plaintiff filed an appeal of the ruling. In June 2006, the Company settled the matter for $30,000.

On January 9, 2001, the Securities and Exchange Commission (SEC) issued a formal order directing a private investigation of the Company and unnamed individuals concerning trading activity in our securities, periodic reports filed by management with the SEC, certain accounting and financial matters and internal accounting controls. We cooperated fully with the SEC. In addition, we received an SEC subpoena for documents related to these matters. The Staff of the SEC advised us that the inquiry was confidential and should not be construed as an indication by the SEC or its staff that any violation of law has occurred, or as an adverse reflection on any person, entity or security. We believe the investigation was primarily related to the previously reported embezzlement by one of our former employees. By letter dated May 31, 2002, we were advised that the investigation undertaken by the Staff of the SEC was terminated and no enforcement action was recommended by the SEC.

From time to time, we are engaged in ordinary routine litigation incidental to our business to which we are a party. While we cannot predict the ultimate outcome of these matters, or other routine litigation matters, it is management s opinion that the resolution of these matters should not have a material effect on our financial position or results of operations.

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

None

Item 4-A. Executive Officers of the Registrant

The key executive officers of the Company, who are not also directors, other than Mr. McNew, are:

Charles L. McNew, age fifty-four is our President and Chief Executive Officer. Mr. McNew has held this position since May 2000. Mr. McNew became a director in 2000. He served as our acting President and Chief Executive Officer from April 2000 to May 2000 and prior to that was our Executive Vice President and Chief Financial Officer from July 1999 until April 2000. Mr. McNew has over 25 years of progressive management experience and has held senior level management positions with a variety of public telecommunications and services companies. Prior to joining the Company, from July 1994 through July 1999, Mr. McNew was Chief Financial Officer and then Chief Operating Officer of Numerex Corporation, a publicly traded wireless telecommunications solutions company.

Mr. McNew has a Master Degree in Business Administration from Drexel University and a Bachelor of Science degree in accounting from Penn State.

Joseph Sciacca, age fifty-three, is our Vice President of Finance and Chief Financial Officer. Mr. Sciacca has been Vice President of Finance and Chief Financial Officer since May 2000. He was appointed Corporate Controller in December 1999 and provided consulting services to us prior thereto beginning in March 1999. From September 1996 through September 1998, he was Chief Financial Officer of On-Site Sourcing, a legal document management services firm. From 1994 through 1996, he was a principal in a tax and consulting firm. Mr. Sciacca has a Masters Degree in Taxation from American University and a Bachelor of Science Degree in Business Administration from Georgetown University.

Hugh Foley, age fifty-four, is our Vice President of Operations. As Vice President of Operations, a position held since April 2002, Mr. Foley manages the service delivery operations for our seat management program, staff augmentation services, as well as IT professional services and product offerings. Mr. Foley joined us in November 1998, initially to manage and implement the Virginia Department of Transportation / Virginia Retirement Systems seat management contract. Prior to joining us, Mr. Foley spent 16 years in the computer service industry in various sales, operations and financial management positions with Sorbus, Bell Atlantic Business Systems, and DecisionOne. Mr. Foley has a Master Degree in Business Administration from Drexel University and a Bachelor of Science Degree in Business Administration from Villanova University.

Douglas H. Reece, age thirty-six, is our Vice President of Sales. Mr. Reece has been with us since November 2001 as Director of Sales and Marketing, and was promoted to Vice President of Sales on April 3, 2006. From October 1999 through November 2001, Mr. Reece worked for Veritas Corporation, a software company, and from August 1999 through September 1999, he was employed by Ernst & Young, LLP where he held various service, sales and operating positions. Mr. Reece has a Master Degree in International Transactions from George Mason University and a Bachelor of Arts in Political Science from West Virginia University.

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our Common Stock, par value $0.24, is listed on the American Stock Exchange under the symbol HX .

At June 5, 2006, there were approximately 199 holders of record of our common stock as reported by our transfer agent and approximately 399 beneficial holders.

The following table sets forth the quarterly range of high and low sales prices as reported by the American Stock Exchange for the last two fiscal years.

	Fiscal Year 2006		Fiscal Year 2005	
Fiscal Quarter	High	Low	High	Low
April June	$ 4.39	$ 3.60	$ 4.80	$ 4.04
July Sept.	4.31	3.40	5.16	3.90
Oct. Dec.	3.85	2.95	6.05	4.45
Jan. March	3.50	2.90	6.01	4.17

On June 5, 2006, the closing price of our common stock on the American Stock Exchange was $2.75.

We did not declare a cash dividend in either fiscal year 2006 or 2005, and there is no assurance we will do so in future periods. Our revolving credit loan agreement prohibits the payment of dividends and limits payment of principal or interest on our subordinated debt without a waiver from the bank. As a Virginia corporation, we may not declare and pay dividends on capital stock, if after giving effect to a dividend our total assets would be less than the sum of our total liabilities or we would not be able to pay our debts when due in the usual course of business. We currently expect to retain our future earnings, for use in the operation and expansion of our business and do not anticipate paying any cash dividend in the future.

See Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters for disclosure regarding our equity compensation plan information.

Item 6. <u>Selected Financial Data</u>

The following table includes selected financial data of Halifax. Our Company s selected consolidated financial information set forth below should be read in conjunction with the more detailed consolidated financial statements, including the related notes, and Management s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this document. This historical selected financial data gives effect to the sale of our secure network services business on June 30, 2005. As a result of the sale of the secure network services business, the results of the secure network services operations for all periods presented have been classified as discontinued operations.

	Years Ended March 31,				
(Amounts in thousands, except share data)	2006[(1)]	2005[(1)]	2004[(2)]	2003[(1)]	2002
Revenues continuing operations	$ 54,911	$ 48,426	$ 40,056	$ 38,974	$ 42,249
(Loss) income from continuing operations	(4,487)	(2,789)	3,493	(122)	36
Discontinued operations	310	1,378	735	770	266
Gain on sale of discontinued operations	5,713				
Net income (loss)	$ 1,536	$ (1,411)	$ 4,228	$ 648	$ 302
Income(loss) per common share basic					
Continuing operations	$ (1.41)	$ (.92)	$ 1.32	$ (.05)	$ .02
Discontinued operations	.09	.46	.28	.35	.12
Gain on sale of discontinued operations	1.80				