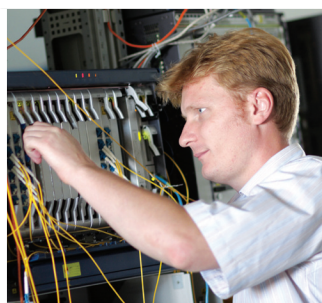




DYNAMICS RESEARCH CORPORATION
2010 Annual Report



FINANCIAL PERFORMANCE

<i>(dollars in thousands, except per share data)</i>	Year ended December 31,		% Change
	2010	2009	
Revenue	\$272,065	\$268,661	1.3%
Operating income	\$ 20,815	\$ 17,908	16.2%
Operating margin	7.7%	6.7%	
Net income	\$ 12,705	\$ 10,172	24.9%
Diluted earnings per share	\$ 1.26	\$ 1.04	21.2%
Net cash provided by operating activities from continuing operations	\$ 41,331	\$ 8,208	

<i>(dollars in thousands, except per share data)</i>	As of December 31,	
	2010	2009
Total assets	\$198,216	\$203,601
Total debt	\$ 22,000	\$ 31,973
Stockholders' equity	\$107,185	\$ 94,096
Return on invested capital	12.8%	8.8%
Stockholders' equity per share	\$ 10.68	\$ 9.48
Return on stockholders' equity	11.9%	10.8%
Funded backlog	\$133,516	\$158,518
Number of shares outstanding	10,040,029	9,923,357



DYNAMICS RESEARCH CORPORATION provides measurable performance improvements for government customers through the delivery of innovative management consulting, engineering, and information technology solutions and services. DRC offers the capabilities of a large company and the responsiveness of a small company, backed by a history of excellence and customer satisfaction.

OUR FIVE GROWTH MARKETS

We are focused on five federal market sectors, projected for strong growth in funding for years to come. These markets represent more than 60 percent of revenue.



- 1. HOMELAND SECURITY
- 2. HEALTHCARE
- 3. CYBER SECURITY
- 4. INTELLIGENCE
- 5. FINANCIAL/REGULATORY

★ Business Solutions:

Business Transformation	●	●	●	●	●
Training and Performance Support	●	●	●	●	●
Information Technology	●	●	●	●	●
Management Services	●	●	●	●	●
Engineering Services					

▲ Contracts:

Alliant		●	●		●
Enterprise Acquisition Gateway to Leading Edge (EAGLE)	●		●		
Professional Program Management Services/Solutions (PPMSS)	●				
Treasury Information Processing Support Services (TIPSS IV)			●		●
TRICARE Evaluation, Analysis, Management & Support (TEAMS)		●			
Business Applications Support Contract				●	
Logistics Management Support Services (LMSS)			●		
Enterprise Integration Services Management (NETCENTS EISM)			●		
Design Engineering Support Program (DESP II)					



INDUSTRIES



DEAR FELLOW SHAREHOLDERS:

DRC has now reported its fourth consecutive year of strong financial results. Our performance compares favorably versus the competition and reflects consistently improving trends, with operating margin and cash flow metrics ranking among the best in our industry. As a result, DRC's stock has outperformed most of its peers over the past two years.

We entered 2011 widely recognized as a leading provider of management consulting, engineering, and information technology solutions and services, well positioned in a number of federal government growth sectors, with a staff of highly talented employees, an enviable portfolio of prime contracts and the proven capabilities to solve complex problems for our clients. DRC's position as a leading mid-size company allows it to bring to bear the personnel, technology resources, and industry-standard practices of a large firm together with the agility of a smaller, more responsive organization.

2010 FINANCIAL PERFORMANCE: We ended the year on a strong note, as demonstrated by increased revenue growth, expanded margins, strong cash flow, and several exciting new contract wins.

For 2010 we reported double-digit revenue growth in our target markets, which represented 60 percent of sales for the year. Our projection is that we will continue to see ample new business opportunities in these markets in 2011 and beyond. Concurrently, our ongoing cost management initiatives yielded additional improvements in 2010, as operating margins rose 100 basis points to 7.7 percent while we generated more than \$40 million of cash from operations. In fact, DRC's cash generating capability, measured as a percentage of revenue, was an industry best for the third consecutive year.

In 2010 we were successful in winning a number of important agency-wide multiple award contracts, which will have a very positive impact on DRC for years to come. These include the Air Force NETCENTS II Enterprise Integration Services Management contract, a five-year program worth \$460 million, and the Department of Treasury Information Processing Support Services (TIPSS) contract, a ten-year \$4 billion program. Such wins point to the value of our services in key, competitive markets where we expect to continue expanding going forward.

Other leading indicators are also trending positively. New business wins for 2010 totaled \$83 million in first year value, an increase of 30 percent over 2009, and our recompetes win rate was strong at 91 percent. At year end, our raw pipeline of new business opportunities stood at \$1.7 billion, up from \$1.3 billion. In addition, for the third year in a row, our book-to-bill ratio was 1 or better. As a result we began 2011 with approximately six months of funded backlog.

GROWING FEDERAL MARKETS: Continuing the pattern we have seen for the last three years, the strength of our recent wins has been driven by the success of our growth strategy—to diversify and invest in developing new business in a select set of fast growing federal market sectors. We are sharply focused on those business areas where, based on long-term market forces, we see sustained government demand for

services that align well with DRC's capabilities. Specifically, we are targeting Homeland Security, Healthcare, Cyber Security, Intelligence, and Civilian Financial and Regulatory Agencies as offering high potential for growth. We are also well positioned in a limited number of promising Department of Defense programs, such as unmanned aerial systems and force readiness. We project continued double digit growth across these market sectors, which we expect will account for 65 percent of total revenue in 2011.

> **Homeland Security.** DRC is today a leading provider of management consulting and information technology services to the Department of Homeland Security, providing enterprise architecture, cyber security, business transformation training and performance support and other management services. While expenditures in this area slowed somewhat in 2010, we expect to see a pick-up in business activity once the EAGLE II and TABSS contracts are awarded in the second half of 2011, further strengthening our position heading into 2012.

> **Healthcare.** In the Healthcare market, particularly military health, we anticipate additional growth in the years to come, as this area will continue to be well funded as a national priority. We forecast Healthcare will represent 11 percent of total revenue this coming year. We see outstanding opportunities for market penetration and future growth within the Veterans Administration as well as the Department of Health & Human Services, which, we believe, will continue to be well funded even in these tough budgetary times.

> **Intelligence.** We are providing mission-enabling solutions to high-level intelligence agencies. In 2010, we saw 12 percent growth in revenue within this market and expect similar strong performance in 2011, with Intelligence growing to 7% of total revenue. In June 2010, we won a significant new prime contract with the Maryland Procurement Office which continues to expand.

> **Financial and Regulatory Reform.** Within the Financial and Regulatory Reform areas, we've seen the country's economic priorities drive increased emphasis on agencies like the Federal Deposit Insurance Corporation, the Internal Revenue Service, and the Pension Benefit Guarantee Corporation—all important DRC customers. Given the recent win of the ten-year Department of Treasury TIPSS contract, we see a significant growth vehicle ahead of us. Also, we believe that last year's Dodd/Frank Wall Street Reform & Consumer Protection Act will continue to fuel initiatives across the spectrum of financial regulation, offering DRC an opportunity to play a major role going forward.

> **Cyber Security.** Perhaps the most significant long-term area for growth is within the cyber security market—the pace of change and emergence of new threats in this area is tremendous. We have a substantial presence in this market today within the Department of Homeland Security, providing an array of services under prime contracts with several of the department's agencies, including the U.S. Secret Service.

LOOKING TO THE FUTURE: In closing, DRC's 2010 results clearly demonstrated strengths across the board—solid organic growth, expanding operating margins, industry-leading cash flow, and significant wins in all of our strategic growth markets. As a result I am highly confident, looking ahead, that DRC is extremely well positioned to deliver further operating performance improvements in 2011 and beyond.

Sincerely,



James P. Regan
Chairman, President and Chief Executive Officer



HOMELAND SECURITY

DRC's solutions in information technology, training, process improvement, and program management are helping to keep America's homeland secure.



U.S. CUSTOMS NATIONAL AIR TRAINING CENTER

▲ Contract

OpSTAR Blanket Purchase Agreement

★ Solutions

*Training and Performance Support
Business Transformation*

CHALLENGE: The U.S. Customs Service National Air Training Center (NATC) needed help to develop and field state-of-the-art, web-based training courses and manage its IT infrastructure.

DRC SOLUTIONS: DRC designs and develops highly interactive web-based courses to support a wide range of missions using our online training development environment. DRC also maintains the NATC training

infrastructure and Web-Based Distribution Network, which is known as OpSTAR. Finally, DRC assists the NATC in managing training tools.

RESULTS: NATC has clearly made significant strides in developing and implementing effective training for Customs and Border Patrol personnel. Training has now been standardized, and training costs have been dramatically reduced. Our superior work has been recognized by NATC leadership. According to the Chief of the Standardization and Training Branch, Oklahoma City National Aviation Center, "...we credit the products and business process reengineering accomplished under this contract with saving the American taxpayer thousands of dollars in associated training costs."



HEALTHCARE

DRC provides an integrated set of practices to help Government healthcare agencies increase performance, reduce costs, and improve patient outcomes. These practices combine our management services, information technology, training and performance support, and business transformation solutions with strong health domain knowledge resulting in a detailed understanding of the unique challenges currently facing the healthcare community.



THE DEFENSE CENTER OF EXCELLENCE FOR PSYCHOLOGICAL HEALTH AND TRAUMATIC BRAIN INJURY

▲ Contract

TRICARE TEAMS

★ Solutions

Management Services

Business Transformation

Training and Performance Support

CHALLENGE: The Defense Center of Excellence (DCoE) for Psychological Health and Traumatic Brain Injury was created to assist our service men and women with psychological health and traumatic brain injuries, including assisting them with their transition back into a fully productive life. The DCoE needed program management support in evaluating

pilot programs, developing best practices, and determining long-term staffing needs.

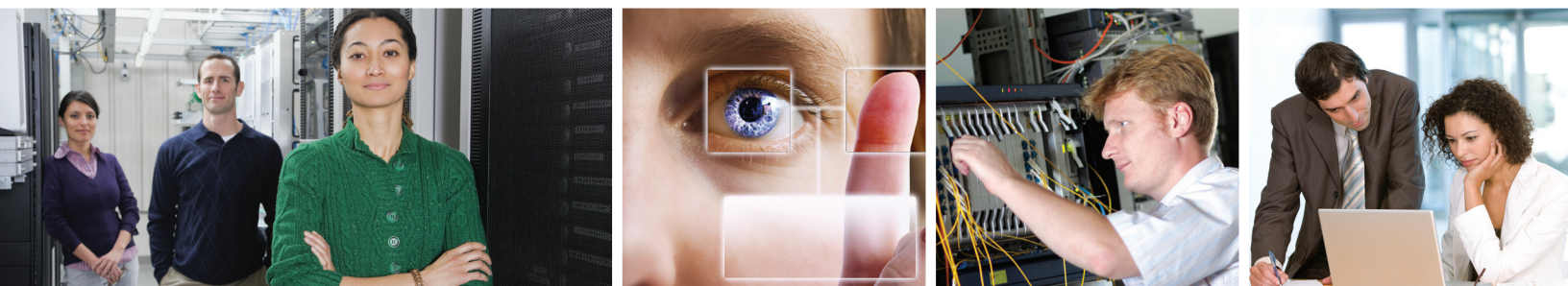
DRC SOLUTIONS: DRC assembled a team with detailed experience and knowledge, as well as outstanding expertise in project management and DoD policies and procedures. The DRC team is now successfully assisting the DCoE in evaluating programs, performing site visits and identifying best practices throughout the DoD. Our program management support is helping the DCoE become the “go to” source for information on programs and methods to optimize the psychological health of our soldiers and their families.

RESULTS: The processes and training developed by the DRC team for the DCoE program evaluations and site visits are helping DCoE target best practices, promoting recovery and reintegration.



CYBER SECURITY

By combining industry standard practices with a highly capable staff that is trained and certified in key security skills, DRC has successfully supported a diverse range of government organizations in meeting the difficult challenges associated with government security compliance.



DHS CHIEF INFORMATION OFFICER, INFORMATION SECURITY OFFICE

▲ Contract

EAGLE

★ Solutions

*Information Technology
Business Transformation
Management Services*

CHALLENGE: In response to the increasing reliance on information systems throughout the federal government as well as increasing threats to the confidentiality, integrity and availability of the data that resides on those systems, DHS needed to improve its security posture to protect critical information systems.

DRC SOLUTIONS: DRC has provided technical assistance and created numerous templates, processes, and guides which have facilitated implementation of a strengthened security posture for systems across the entire Department. DRC has also developed and implemented an information security data warehouse and reporting tool that generates daily performance indicators regarding the security posture of the Department.

RESULTS: At the time DRC was selected for the original effort, DHS's security programs had been graded a "D" on the OMB FY07 Federal Information System Management Act (FISMA) Scorecard. As a result of the performance improvements implemented, DHS was graded as a "B+" on the OMB FY08 FISMA Scorecard.



INTELLIGENCE

Since 1992, DRC has supported a number of clients in the intelligence community with a wide range of services including software development and infrastructure management, training, business process reengineering, document management systems planning and implementation records management, and system security support.



BUSINESS APPLICATIONS SUPPORT

▲ Contract

Business Applications Support Blanket Purchase Agreement

★ Solutions

*Information Technology
Business Transformation
Management Services*

CHALLENGE: An intelligence community customer needed support for developing, designing, and implementing business management solutions for the global enterprise.

DRC SOLUTIONS: DRC is providing high level support in the areas of: business process reengineering, document management systems planning and

implementation, records management, system planning and implementation, workflow application planning, definition, configuration, testing, user training and implementation. As part of this effort, we are helping our customer implement Microsoft Office SharePoint Server 2007 solutions for electronic records management in accordance with Government standards. DRC is also helping the customer use Commercial-Off-The-Shelf tools to address its document management, document imaging and workflow management needs.

RESULTS: Through the introduction of new technology, we are helping our customers develop, design, and implement business management solutions for its global enterprise. These technologies help our customer enable collaboration and communication across its enterprise.



FINANCIAL AND REGULATORY

Federal financial agencies are being asked to provide enhanced services and increased efficiencies while implementing major reforms. To meet these challenges, we offer help in the areas of Business Transformation, Management Services, Training, and Information Technology.



FEDERAL DEPOSIT INSURANCE CORPORATION, OFFICE OF THE CIO, BUSINESS ANALYSIS AND MANAGEMENT SUPPORT SERVICES

▲ Contract

BAMSS Blanket Purchase Agreement

★ Solutions

*Business Transformation
Information Technology
Management Services*

CHALLENGE: As it strives to protect the safety and soundness of our nation's banking system, the FDIC faces an increasingly complex regulatory environment. To address these new challenges, the FDIC is developing more efficient and robust information technologies. The realization of these business

enhancements required a business partner with extensive technical expertise and proven strategic planning capabilities.

DRC SOLUTIONS: DRC provides specialized expertise in the areas of: IT strategic planning; business process improvement; regulatory change; IT capital investment and planning; software development planning; IT portfolio, program and project management; enterprise architecture; and quality assurance.

RESULTS: Since inception, the program has had an impact across all lines of business within the FDIC, establishing best practices, providing strategic plans and supporting the FDIC through all phases of the development lifecycle. We have provided the technical support needed to promote efficient development of enhanced business solutions.

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

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2010

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from **to**

Commission file number 001-34135

DYNAMICS RESEARCH CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Massachusetts

(State or other Jurisdiction of incorporation or organization)

04-2211809

(I.R.S. Employer Identification No.)

Two Tech Drive, Andover, Massachusetts

(Address of Principal Executive Offices)

01810-2434

(Zip Code)

Registrant's telephone number, including area code

(978) 289-1500

Securities registered pursuant to Section 12(b) of the Act:

Title of each class
Common Stock, \$0.10 par value

Name of exchange on which registered
The NASDAQ Global Market

Securities registered pursuant to Section 12(g) of the Act:

None

(Title of class)

- Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No
- Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes 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. Yes No
- Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). * The registrant has not yet been phased into the interactive data requirements. Yes No
- 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.
- Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
- Indicate by check mark whether the registrant is a shell Company (as defined in Rule 12b-2 of the Exchange Act). Yes No
- The aggregate market value of the registrant's common stock, \$0.10 par value, held by nonaffiliates of the registrant as of June 30, 2010, was \$85.4 million based on the reported last sale price per share of \$10.11 on that date on the NASDAQ Global Market. As of February 25, 2011, 10,078,718 shares of the registrant's common stock, \$0.10 par value, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement involving the election of directors, which is expected to be filed within 120 days after the end of the registrant's fiscal year, are incorporated by reference in Part III of this Annual Report on Form 10-K ("Form 10-K").

INFORMATION RELATED TO FORWARD-LOOKING STATEMENTS

Some of the statements under "Business", "Management's Discussion and Analysis of Financial Condition and Results of Operations", and elsewhere in this Form 10-K contain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, regarding future events and the future results of Dynamics Research Corporation ("DRC") that are based on current expectations, estimates, forecasts and projections about the industries in which DRC operates and the beliefs and assumptions of the management of DRC. Words such as "anticipates", "believes", "estimates", "expects", "intends", "plans", "projects", "may", "will", "should" and other similar expressions are intended to identify such forward-looking statements. These forward-looking statements are predictions of future events or trends and are not statements of historical matters. These statements are based on current expectations and beliefs of DRC and involve a number of risks, uncertainties and assumptions that are difficult to predict. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this document or in the case of the statements incorporated by reference. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in this Form 10-K under the section entitled "Risk Factors". Except to the extent required by applicable law or regulation, DRC undertakes no obligation to revise or update publicly any forward-looking statements for any reason.

DYNAMICS RESEARCH CORPORATION
ANNUAL REPORT ON FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2010
TABLE OF CONTENTS

	<u>Page</u>
PART I	
ITEM	
1. Business	2
1A. Risk Factors	16
1B. Unresolved Staff Comments	26
2. Properties	26
3. Legal Proceedings	26
4. [Removed and Reserved]	26
PART II	
ITEM	
5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	27
6. Selected Financial Data	29
7. Management's Discussion and Analysis of Financial Condition and Results of Operations	31
7A. Quantitative and Qualitative Disclosures About Market Risk	42
8. Financial Statements and Supplementary Data	43
9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	76
9A. Controls and Procedures	76
9B. Other Information	77
PART III	
ITEM	
10. Directors, Executive Officers and Corporate Governance	78
11. Executive Compensation	79
12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	79
13. Certain Relationships and Related Transactions, and Director Independence	79
14. Principal Accounting Fees and Services	79
PART IV	
ITEM	
15. Exhibits and Financial Statement Schedules	80

PART I

ITEM 1. BUSINESS

CORPORATE OVERVIEW AND STRATEGY

Dynamics Research Corporation is a leading provider of innovative management consulting, engineering and information technology ("IT") services and solutions to federal and state governments.

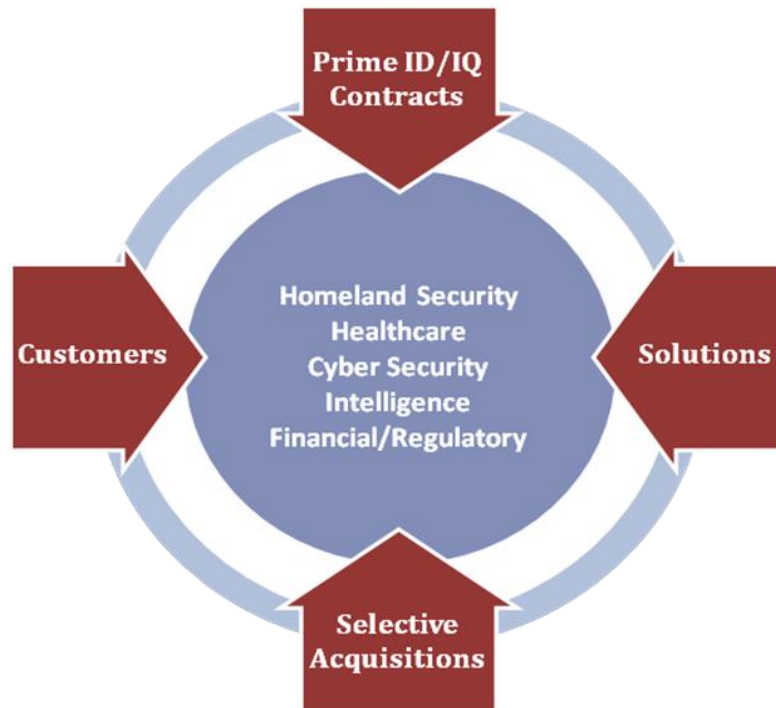
Our go-to-market strategy is sharply focused within each of four dimensions:

•**Solutions.** We deliver high-value differentiated solutions to our clients. Our five areas of differentiated expertise are business transformation, information technology, training and performance support, management services and engineering services. We believe our solutions align well with the needs of our government customers today through improved efficiencies and effectiveness, procurement reform, transformational and technology based changes, and ongoing, changing security threats.

•**Markets and Customers.** We target markets, which based on long-term market force drivers, have sustained government projected demand for services. We select customers from the spectrum of federal government departments and agencies in our target growth markets with needs that well match the solutions we provide. Currently our target growth markets include homeland security, healthcare, cyber security, intelligence and financial/regulatory reform. In 2010 approximately 60% of our revenue was derived from clients in these markets and selected high growth areas of defense such as unmanned aerial systems and force readiness and training. Our 2010 revenue derived from these markets grew 12% over 2009.

•**Prime Government and Agency-Wide Contracts.** We hold an enviable portfolio of government and agency-wide multiple award schedule indefinite delivery/indefinite quantity ("ID/IQ") task order contracts. Today, these types of contracts are the federal government's preferred means of procurement for services.

•**Acquisitions.** We use acquisitions, funded through both operationally generated cash and leverage, to strengthen our position in our target growth markets.



Our position as a leading mid-size company allows us to bring to bear the personnel, technology resources and industry standard practices of a large company with the responsiveness of a small company. Rather than force a pre-packaged solution, we listen to our customers and develop tailored solutions based on proven industry practices and lessons learned in hundreds of successful engagements. We offer forward-thinking solutions backed by a history of excellence and customer satisfaction.

Founded in 1955 and headquartered in Andover, Massachusetts, DRC has approximately 1,300 employees located throughout the United States. DRC operates as a parent corporation and through its wholly owned subsidiaries, Kadix Systems, LLC, H.J. Ford Associates, Inc. and DRC International Corporation. Unless the context otherwise requires, references in this Form 10-K to “DRC”, “we”, “us” or “our” refer to Dynamics Research Corporation and its subsidiaries.

As of December 31, 2010, our only reportable business segment was Systems and Services.

SOLUTIONS

Business Transformation

We provide a comprehensive set of services and tools for rapidly transforming organizations and significantly improving organizational performance. Our services in this area include applying proven, repeatable processes, such as Lean Six Sigma and Theory of Constraints, to the entire life cycle of business transformation and aligning improvements with overall organizational objectives and strategies. We provide web-based collaborative decision making tools and facilities that enable participants in different locations to quickly and cost-effectively participate in the transformation process. We have an established track record in providing our business transformation customers with high returns on their investment and positive impacts on performance. Because we have no pre-selected solution or proprietary software packages to sell, we tailor our processes and tools to meet each customer’s unique needs.

Information Technology

DRC provides a range of processes and tools to develop, sustain, manage and govern complex information systems. Our areas of practice include enterprise architecture, software engineering, IT infrastructure management, application development and sustainment, web services, IT governance, information assurance and cyber security, IT support services such as change management, quality assurance and testing, automated case management, and data engineering.

We develop software using Capability Maturity Model Integration for Development Maturity Level 3 processes and provide services to support the ongoing development and subsequent maintenance of an organization’s enterprise architecture. We offer a comprehensive set of services for managing and implementing IT infrastructures for Government organizations based on the International Organization for Standardization (“ISO”) 20000-1:2005 for IT Service Management.

DRC provides integrated processes and services to help Government agencies govern their IT systems in accordance with various Government regulatory requirements such as Capital Planning and Investment Control and the Federal Information Security Management Act. We also provide a set of information assurance cyber security services, which includes management support, operational support and technical support for the identification and mitigation of security risks.

Training and Performance Support

Our training solutions are an integral part of a broader assessment of human performance within an organization or system. Our methodology integrates industry best practices in human performance assessment of organizations, instructional systems development, and human systems integration of complex systems. Our training encompasses individual training as well as team training. We are an industry leader in the development of team training applications for mission critical teams. Our training solutions include training/task analysis, high-performance team

training, web-based training and automated training management. As part of our integrated methodology, we also identify, develop and deliver a variety of additional human performance improvement solutions, including electronic performance support systems, job/task redesign user interface change, organizational redesign and resource reallocation.

Our strategic human capital, workforce planning and performance management solutions help transform the cultures of Federal agencies so they become less hierarchical, process-oriented, stove-piped and inwardly focused; and more flat, results-oriented, integrated, and externally focused. DRC combines the best commercial and Government sector approaches to deliver innovative human capital solutions that address the challenges facing our clients today.

Management Services

We provide a comprehensive set of solutions to support the management of complex programs throughout their life cycle, providing expertise in program management, business, cost, financial management, acquisition management, engineering and logistics services, audit support and remediation services, communications services and training.

Engineering Services

We provide engineering services to support the design, testing, manufacturing and integration of advanced components and complex systems. Our areas of engineering expertise include: (i) item unique identification methodologies, (ii) technical manual configuration and control, (iii) manufacturing, repair and overhaul engineering including technical assessment of these processes, and (iv) GPS receiver products, which comply with the Navigation Satellite Timing and Ranging Joint Program Office performance specification for standard electronic module Type E GPS receivers. These GPS receiver products are powerful and versatile modules that provide robust GPS solutions used for navigation and for hot starting the embedded GPS receivers of precision guided munitions.

MARKETS

We target markets which based on long-term market force drivers, have sustained government projected demand for services. We select customers from the spectrum of federal government departments and agencies in our target growth markets with needs that well match the solutions we provide. Currently our target growth markets include homeland security, healthcare, cyber security, intelligence and financial/regulatory reform. We also serve the (i) command and control, surveillance and reconnaissance, and (ii) force and weapons systems readiness markets, including training, performance support, human capital, logistics, transportation, life-cycle systems management, repair and maintenance.

In 2010 approximately 60 % of our revenue was derived from clients in these markets and selected high growth areas of defense such as unmanned aerial systems and force readiness and training. Our 2010 revenue derived from these markets grew 12% over 2009.

We believe our core capabilities are well aligned with the types of services and solutions for which the government has increasing demands including: (i) improved efficiencies and effectiveness (ii) procurement reform (iii) transforming the delivery of government services through organizational change, process improvement and technological change and (iv) responding to rapidly changing security threats.

We are cognizant of funding challenges and changing priorities of the federal government. Federal IT spending grew 6.8%, 4.6% and 2.4% for 2008, 2009 and 2010 government fiscal years, respectively. For fiscal year 2011 the federal government is currently operating under continuing resolution, which generally authorizes Departments to operate at expenditure levels approved in the previous fiscal year budget cycle, but tends to delay funding of current programs and restrict initiation of new programs. Under the current continuing resolution, Federal IT spending for the current fiscal year 2011 is projected at \$78.5 billion, an increase of 0.7% over fiscal year 2010. The Administration's budget request for fiscal year 2012 included IT spending growth of 1.3% over the current projected levels of spending for fiscal year 2011 under the continuing resolution.

The federal government also has set high priority and is initiating programs focused on strengthening the government workforce with particular emphasis on personnel responsible for acquisition, such as, acquiring products and services for the government. The government has set targets for adding to the government workforce with some of these positions coming from a reduction in the number of contractor positions supporting the government, known as in-sourcing. We have experienced a modest reduction in positions and revenue from in-sourcing on our business and anticipate continuation of this program in 2011. We also are seeing increasing demand for human capital and training solutions in support of government initiatives to strengthen the federal workforce.

In the state and local government sector, which is less than 10% of our total business, new contract opportunities are limited as the states address balanced budget requirements and lower tax revenues. We anticipate procurement activities in 2011 as the fiscal environment in some states stabilizes. There is a need for states to continue to modernize child welfare systems and Medicare management systems, areas where our automated case management solution fits well. We have considerable experience in providing IT expertise in the health and human services areas. We believe the primary factors driving growth in this sector are infrastructure modernization and expansion, the migration of information and training to web-based applications and cost-sharing incentives to facilitate data exchange with federal agencies.

MAJOR CUSTOMERS

Our 2010 revenue was derived 66.1% from the national defense and intelligence sector, 18.5% from homeland security, 8.8% from other federal civilian agencies and 6.6% from state and local governments.

National Defense and Intelligence Sector

U.S. Air Force customers constituted the largest component of our national defense and intelligence revenue in 2010, representing approximately 25% of total revenue, while U.S. Army revenue represented 19%, U.S. Navy revenue represented 9% and revenue from other agencies represented 13% of total revenue. The work we perform for our major customers in this sector is described below.

U.S. Air Force Customers

Materiel Command, Aeronautical Systems Center

The Aeronautical Systems Center (“ASC”), headquartered at Wright-Patterson Air Force Base, is responsible for research, development, testing, evaluation, acquisition and life cycle management of aeronautical systems and related equipment for the Air Force.

We support ASC system program offices with program management, logistics, engineering, acquisition management, analytical, and administrative services for both the United States Air Force and various foreign military sales programs. The active programs we currently support include the Medium Altitude Unmanned Aircraft Systems (Predator/Reaper), Reconnaissance Systems, F-16, F-22, B-2, C-17 and Special Operations Forces.

Materiel Command, Electronic Systems Center

The mission of the U.S. Air Force Electronic Systems Center (“ESC”), headquartered at Hanscom Air Force Base in Bedford, Massachusetts, is to serve as the center of excellence for command and control and information systems to support the U.S. Air Force and the DoD.

In December 2010, we were one of six awardees for the NETCENTS-2 Enterprise Integration and Service Management (“EISM”) \$460 million contract. Through the EISM contract the Air Force is expected to procure IT portfolio management analyses, enterprise-wide and cross-domain engineering and architectural analyses, enterprise business process reengineering solutions, enterprise service standards and processes, service performance assessments and scalability planning, and services to develop plans and strategies to implement new service oriented architectures.

We provide technical and subject matter experts supporting the implementation of the Air Force's Expeditionary Combat Support System.

We provide software maintenance, sustainment and enhancement services in support of the Air Force Weapons Systems Management Information System ("WSMIS"). WSMIS is the Air Force's operational system for global tracking of Air Force parts and weaponry. We also support the integration of WSMIS with other Air Force systems and initiatives.

We evaluate system requirements, provide technical services, support the integration of products into airborne and ground weapons systems, and provide management services supporting ESC systems program offices, including the Multi-Platform Radar Technology Insertion Program and Airborne Warning and Control Systems programs.

Materiel Command, Depot Operations

We perform engineering logistics, IT management, operations analyses, systems engineering and technical services for the U.S. Air Force's Air Logistics Centers at Tinker and Hill Air Force Bases in Midwest City, Oklahoma and Ogden, Utah, respectively, supporting the B-1B, the B-52, the C-5 and the KC aircraft programs.

We provide developmental research and engineering services and solutions for the Item Unique Identification umbrella program for Air Force depots. We provide comprehensive analysis of tagging and labeling methods, including detailed studies of adhesives durability in operational environments. Our efforts assist in the identification of state-of-the-art asset tracking technology and help improve asset tracking throughout the life cycle of all DoD assets.

Materiel Command, Global Logistics Support Center

We provide data quality support services that identify and eradicate faulty data anomalies associated with Air Force logistics systems. As part of this ongoing program, we determine the extent of interface and system data quality problems, identify discrepancies, initiate corrections and provide visibility of data as well as maintain web applications that assist in the tracking, scanning and organizing of data to identify anomalies in the system and correct them.

Air Combat Command

Since 2006, we have been assisting Lockheed Martin with the development and implementation of a new Air and Space Operations Center ("AOC") operating system which integrates more than 20 systems into a common hardware and software baseline. We also provide on-going support to current AOC systems at Langley Air Force Base in Hampton, Virginia.

We provide the Air Force Command and Control Integration Center with engineering services and program management support for the Air Force Tactical Data Link program. We also provide scientific and technical services for the engineering and integration of warfighter vocabularies.

Air Mobility Command

We provide program planning, enterprise architecture, systems engineering, decision support, logistics thought leadership, subject matter expertise and business analysis services to the Air Mobility Command.

U.S. Army Customers

Training and Doctrine Command

We are one of five prime contractors awarded the Training, Doctrine and Combat Development ID/IQ contract, which has a ceiling of \$97 million to provide training, doctrine and combat development to the U.S. Army Armor Center at Fort Knox, Kentucky. DRC provides training development support to the Heavy Brigade Combat Teams

("HBCT") as the Army transitions the Armor Center from Fort Knox to the Maneuver Center of Excellence at Fort Benning, Georgia. We are developing the architecture and automated tools for the U.S. Army Armor Center knowledge management continuity effort and executing the plan to transition knowledge to the Maneuver Center of Excellence.

For the Maneuver Center of Excellence, we develop and revise the Army tactics, techniques and procedures manuals and training products. We also support the Armor School's HBCT Tactical Leader Course. For the Human Capital Enterprise we prepared a comprehensive analysis to improve human capital systems and processes.

We assisted in writing the Joint Capabilities Integrated Development System documents for the Army's HBCT, security and reconnaissance acquisition programs.

We assist the U.S. Army Training and Doctrine Command Analysis Center at Fort Leavenworth, Kansas in conducting studies and analysis to advance U.S. Army doctrine, organization, training, material, leadership, personnel and facilities ideas associated with U.S. Army transformation. We help develop, manage, operate and maintain the tools, scenarios, data and simulation needed to enable the analysis.

Army Research Institute

For the Army Research Institute we evaluate training courses and materials and gauge their ability to train soldiers to achieve mission objectives. We provide training requirements analysis, training programs and evaluation tools and methods, which enable Army units to utilize digital training programs and advanced distributed learning approaches.

Medical Research Institute for Chemical Defense

The mission of the U.S. Army Medical Research Institute for Chemical Defense is to develop medical countermeasures to chemical warfare agents and to train medical personnel in the medical management of chemical casualties.

For the Medical Research Institute for Chemical Defense, we maintain courseware, modify course content and descriptions and track courses. We provide academic outreach and communications program support to retain, recruit, transition, and provide outreach and education to new talent acquired through internships, the Oak Ridge Institute for Science and Education and the National Research Council.

Software Engineering Center

We provide business consulting, software product development and sustainment support to the Army Software Engineering Center. We modernized the Army Food Management Information System to better serve its customers and to manage food services for 350 dining facilities and 53 Army/Army Reserve installation operations worldwide. We have assisted in strategic planning, functional requirements gathering and the evaluation of commercial food service software and have lead the development and integration of commercial and custom-developed software.

Aviation / Missile Command

We provide programmatic consulting, engineering and logistics management to the U.S. Army Materiel Command and U.S. Army program executive officers for acquisition of major weapon systems. Our engineers analyze and review airframe, avionics, aeromechanics and propulsion issues for U.S. Army project managers, provide logistics and fielding support, and prepare electronic technical manuals for rotary and fixed-wing aircraft systems. We also support other U.S. Army activities with acquisition logistics, systems engineering and other related program management services for the U. S. Army Aviation and Missile Command and Communications-Electronics Command.

U.S. Navy Customers

Naval Surface Warfare Center

We design, develop, secure, maintain, and enhance the networks for this client, providing information assurance and cyber security services.

Naval Air System Command

For the Naval Air System Command we provide assistance in implementing *AIRSpeed*, the Navy's continuous improvement initiative for improving the operational effectiveness of naval aviation maintenance and supply. We provide Lean Six Sigma training and technical support services for maintenance facilities around the world.

Office of Naval Research

We provide engineering, IT and business transformation services to two Office of Naval Research programs, Manufacturing Technology and Lean Pathways.

United States Marine Corps Systems Command

We provide the Marine Corps Systems Command with software support services for the Marine Corps' SPA Module. The SPA Module, developed for the SIPRNet, provides operational force commanders with an effective tool to accurately and timely account for deployed personnel under their cognizance.

Other Defense Agency Customers

Maryland Procurement Office

We provide business process reengineering, records management and workflow application development and implementation solutions to this client.

Defense Logistics Agency

We are helping the Defense Logistics Agency fully implement a continuous process improvement infrastructure, which will achieve better efficiency, effectiveness and flexibility of the agency's logistical and technological services. Our Lean Six Sigma credentialed staff provides the methodologies, tools and expertise to implement business improvement practices which have already led to improvements such as reduced cycle times for critical agency processes.

Office of Assistant Secretary of Defense for Health Affairs

In 2008, we were awarded a ten-year ID/IQ contract by the Office of the Assistant Secretary of Defense for Health Affairs, which includes the TRICARE Management Activity. The TEAMS contract provides a vehicle for obtaining services in support of policy development, decision-making, management and administration, program and/or project management and administration. We were one of 23 companies awarded the TEAMS contract, which has a total ceiling value of \$5 billion.

We have won a number of task orders under the contract supporting the TRICARE Traumatic Brain Injury and Psychological Health Program, the Defense Center of Excellence, the Military Medical Support Office, the Northern Regional Medical Command, the Military Health System Strategic Communications Office and the Walter Reed Army Medical Center. DRC provides program management, program evaluation and analysis, clinical support, project coordination and administrative services.

Defense Media Activity Office

We provide the Defense Media Activity office with thought leadership, analysis, and technical expertise on emerging media options and creative services in the form of writing, editing, videography and web site design and development.

U.S. Transportation Command

We provide logical and physical data modeling expertise, data engineering and management support services to the U.S. Transportation Command.

Missile Defense Agency

The Missile Defense Agency is chartered with developing the future space-based missile defense capabilities. We provide research on manufacturability and productability to this client under multi-year contracts.

Joint Strike Fighter (F-35) Program Office

Our work encompasses a variety of services in the areas of logistics, strategic planning, business operations management and technical assessment and analysis. We assist in the evaluation and development of acquisition and sustainment strategies, provide analytical support for government validation and verification of the autonomic logistics system and provide technical support for model enhancement, business process improvement initiatives and recommendations for performance-based program metrics that capture operational and supportability requirements.

Department of Homeland Security

We provide solutions and services to all seven major DHS components, as well as department level offices.

Department of Homeland Security Headquarters, Office of the Chief Information Officer

We deliver management services assisting the DHS Office of the Chief Information Officer (“OCIO”) with IT policy and planning, investment and portfolio management, enterprise architecture, information assurance and IT security, and information sharing. We also provide oversight and assessment services for the IT Services Office. We work closely with portfolio owners to resolve conflicts and facilitate agreements among competing interests and provide a neutral perspective to decision-makers who need to choose specific technology and mission targets. We also provide capital planning and investment training.

We provide enterprise architecture services, which help improve organizational performance and core business processes, ensure that investments are cost-effective and mission-focused and that its IT programs and assets are well-managed to maximize their return on investment.

We provide a wide array of information security services to the DHS Information Security Office’s Compliance Division, including supporting the DHS Information Security Performance Plan and ensuring compliance with the FISMA. We are responsible for conducting Certification and Accreditation document reviews, technical reviews of critical controls, as well as reviews of information security programs within DHS agencies. DRC personnel maintain the DHS FISMA inventory, provide technical subject matter expertise to assist in developing and implementing remediation Plans of Action and Milestones in response to audit findings, and provide training to information security personnel across DHS agencies.

Immigration and Customs Enforcement

We provide business engineering services, technical support, design and architectural support required to assist with the development of enterprise and system-level architectures for the Office of the Chief Information Officer for Immigration and Customs Enforcement (“ICE”). The tasks include system and software engineering, systems integration, system security and program documentation required for continued software support and requirements management. We support the ongoing development and subsequent maintenance of the ICE enterprise architecture

planning artifacts. The enterprise solution we are helping to develop provides the framework for fully integrating ICE systems and provides the basis for continuously evaluating and assessing transformation efforts.

Using an IT investment management framework and value-driven reengineering methodology we provide the ICE OCIO program executive office with the resources, processes and expertise required to better manage the ICE IT investment portfolio. We also assist in implementing project management best practices that encourage collaboration and integration for improved project performance.

United States Coast Guard

We assist the Coast Guard information system security manager in responding to notices of findings and recommendations from recent audits. We provide support to the Coast Guard in the analysis of their recent audit results and development of improvements to IT policies, procedures, and practices in order to ensure that the audit results are adequately addressed and compliance with DHS requirements is achieved.

DRC provides mission and capabilities analysis for Coast Guard modernization projects identifying and aligning strategic, operational and tactical mission and task requirements.

U.S. Citizenship and Immigration Services

We provide the U.S. Citizenship and Immigration Services (“USCIS”) with comprehensive quality assurance program management services for the USCIS Application Support Centers biometrics system. USCIS requires applicants and petitioners for certain immigration benefits to be photographed and fingerprinted for the purpose of conducting criminal background checks. To facilitate this effort, DRC provides support in data management, scheduling, trends analysis, equipment utilization, personnel support, special projects, standard operating procedures and project reporting.

Customs and Border Protection

We develop functional Web-based training courseware to meet the training and simulation needs of the Customs and Border Protection Office of Air & Marine. We designed, implemented and currently maintain their OpSTAR network to meet the training, distribution and tracking needs of the National Air Training Center. We also provide flight training support, tactical scenario based instruction, and meet other related training needs. We also developed and support the Customs and Border Protection’s Procurement Directorate Knowledge Management System.

Federal Emergency Management Agency

We support the Federal Emergency Management Agency (“FEMA”) by providing guidance, training, and feedback to the components on the development and maintenance of plans of action and milestones in response to audit findings. We also review plan of action and milestones data and present current information to FEMA system security officers, managers, and owners, utilizing existing audit database and shared network drive to track audit requests and remediation efforts to further ensure timely delivery of information.

We provide the FEMA Office of External Affairs with communications strategy, message coordination, analyses and guidance, relationship-building and decision support services.

Transportation Security Administration

We provide project and program management, business process improvement and knowledge management solutions to the Transportation Security Administration’s National Explosives Detection Canine Team Program which deters and detects the introduction of explosive devices into the transportation system. DRC serves as Information System Security Officer for several Transportation Security Administration mission-critical applications, including SABRE and the Staffing Allocation Model Forecasting Tool, a modeling application that analyzes incoming flight data to calculate the staffing levels needed to operate security operations for more than 470 airports.

United States Secret Service

We provide the United States Secret Service Chief Information Security Officer with information assurance and system security services and solutions.

Federal Civilian Agencies

Pension Benefit Guaranty Corporation

The Pension Benefit Guaranty Corporation Enterprise Program Management Office has a mission to maintain corporate integrated IT Governance and Management framework policies, processes, procedures, standards and guidelines. We help the Office meet its quality management objectives through the conduct of compliance audits and the development and implementation of continuous improvement programs.

Federal Deposit Insurance Corporation

The Federal Deposit Insurance Corporation (“FDIC”) is striving to continually improve the overall operating efficiency and effectiveness of its IT resources. Through our business analysis and management support services, we identify opportunities for improved efficiency and effectiveness of its IT resources. We also are providing training systems development solutions to the FDIC.

Office of Personnel Management

We provide human capital and training support to the Office of Personnel Management.

Internal Revenue Service

We provide the Internal Revenue Service (“IRS”) IT support to the Enforcement Revenue Information System where we provide independently-assessed CMM Level 3 IV&V support.

We also supply the IRS with professional support and consulting services to the Transition Management Office which does organizational preparedness assessments for application implementation.

In late 2010, we were one of thirty-three recipients of a prime contract award for the ten-year, \$4 billion Department of Treasury’s Total Information Processing Support Services (“TIPSS-4”) contract. The TIPSS-4 contract vehicle is intended to provide information processing support services for the Department of the Treasury, IRS, and Treasury bureaus, and can be used by other federal agencies. The IRS, who will be the primary user of TIPSS-4, is expected to use the vehicle to obtain a full range of information processing support services for its projects and programs. Specific task orders will be awarded in four major areas: information technology development, operations and maintenance, cyber security and program management support. The work will also include specialized support in domains such as systems engineering, applications development, personnel training, IT security planning and business process transformation.

Department of Veterans Affairs (VA)

We provide IT IV&V support to several Veterans Administration IT efforts.

State and Local Government Sector

State of California

Under a subcontract, we provide the training and performance support solution component of a \$245 million project for the California Department of Corrections and Rehabilitation's Strategic Offender Management System Project. We also provide the State of California with an innovative, multidimensional training program to ensure the highest level of user effectiveness on the new system while minimizing impact on normal business operations. Our team provides train-the-trainer courses to more than 1,200 state trainers.

State of Tennessee

For the State of Tennessee, we customized our State of Ohio web-based Statewide Automated Child Welfare System solution, aligning it with the State of Tennessee's unique child welfare practices. The new system called the Tennessee Family and Child Tracking System ("TFACTS") was successfully implemented in 2010. Our solution enables vast improvements in the state's case management capabilities.

State of Colorado

We designed, built and currently support a network for the Colorado Department of Human Services, which connects more than 11,000 end users at 130 sites with the State's child welfare benefits management system.

For an important State of Colorado Department of Revenue program, DRC had a major role in developing an architectural plan and building the infrastructure that supports the state's new tax system. We also provide IT operations support and security management services for the state's voter registration system.

CONTRACTS

Government Contracting Methods

The government procures services through the use of either definite or indefinite contract awards. Through definite contracts the government procures from a single vendor a stipulated set of services over a specified time period using a defined price mechanism. Such contracts are most often awarded on the basis of a competitive bid process and evaluation.

The preferred means by which the government procures services today is through indefinite contract awards, commonly referred as agency-wide ID/IQ contracts. Occasionally, these contracts are issued to a single provider but most often they are issued for multiple years to multiple vendors. The number of vendors awarded an indefinite contract vehicle, or ordering contract, is limited in order to make the process of issuing work orders under the contract more efficient. Once the master contract is issued, individual task orders are competed amongst the contract holders with individual awards setting out work to be performed, period of performance and pricing for each order.

These vehicles have enabled contracting officers to accelerate the pace of awards. Concurrently, under current budgetary pressures, our customers have the flexibility to delay awards, reduce funding or fund work on an incremental basis. Foreseeing this trend, the acquisition of these contracts is a strategic priority for DRC. Today, we hold a broad portfolio of these prime contracts, including the following:

<u>Market</u>	<u>Sponsoring Agency</u>	<u>M/S⁽¹⁾</u>	<u>Contract Name</u>
Government Wide	General Services Administration	M	Alliant
Government Wide	Office of Personnel Management	M	Training and Management Assistance (TMA)
Homeland Security	Department of Homeland Security	M	Enterprise Acquisition Gateway to Leading Edge (EAGLE)
Homeland Security	Department of Homeland Security	M	Professional Program Management Services/Solutions (PPMSS)
Financial/Regulatory	Department of Treasury	M	Treasury Information Processing Support Services (TIPSS IV)
Financial/Regulatory	Federal Deposit Insurance Corporation	S	Business Analysis Management Support Services (BAMSS)
Healthcare	TRICARE (Department of Defense)	M	Evaluation, Analysis, Management & Support (TEAMS)
Intelligence	Maryland Procurement Office	S	BajaSands
Readiness	Army Training and Doctrine Command	M	Simulation & Training Omnibus Contract (STOC II)
Readiness	Army Research Institute	M	Research, Development & Analysis in Army Training (TRAIN II)
Readiness	Department of Defense	M	Logistics Management Support Services (LMSS)
Readiness	U.S. Air Force	M	Enterprise Integration Services Management (NETCENTS EISM)
Readiness	U.S. Air Force	M	Design Engineering Support Program (DESP II)

(1) M = Multiple Award; S = Single Award

The EAGLE, PPMSS, BAMSS and DESP II contracts are currently under re-competition for successor contract vehicles. We believe we are well positioned to win successor contracts in each circumstance. However, the outcomes from the competitions remain uncertain and there can be no assurance that successor contracts will be awarded to DRC.

Prime Contracts and Subcontracts

We provide our services and solutions as a prime contractor for 73% of our revenues in 2010, up from 71% in 2009 and 63% in 2008. The remainder of our work, which was nearly entirely for government end customers, was performed as a subcontractor to another company, who held a prime contract with a government customer for the delivery of the services we provided. We are submitting an increasing portion of our contract proposals as a prime contractor, wherein we are responsible for the entire contract engagement, including the work of subcontractors. On large, complex engagements we often engage subcontractors as teaming partners to fully address the capability requirements of our clients.

Types of Contract Pricing

Our U.S. Government contracts fall into one of three categories: (i) fixed-price, both completion and term (which operate similar to time-and-material), including service-type contracts, (ii) time-and-materials, and (iii) cost reimbursable. Under a fixed-price contract, the U.S. Government pays an agreed upon price for our services or products, and we bear the risk that increased or unexpected costs may reduce our profits or cause us to incur a loss. Conversely, to the extent we incur actual costs below anticipated costs on these contracts, we could realize greater profits. Under a time-and-materials contract, the U.S. Government pays us a fixed hourly rate, which is intended to cover salary costs and related indirect expenses, to include a profit margin. Under a cost reimbursable contract, the U.S. Government reimburses us for our allowable direct expenses and allowable and allocable indirect costs and pays a negotiated fee.

In recent years, there has been an increase in the portion of contracts issued on a fixed price basis, compared with time-and-materials or cost-reimbursable, in an effort to reduce the risk to the government of cost overruns. We believe our contract cost management capabilities are strong and view this trend as favorable to the company. The amount of our revenue derived from fixed price contracts in 2010 was 47%, up from 40% in 2009 and 33% in 2008.

Contract Terms and Conditions

Our contracts with the U.S. Government customers generally are subject to compliance with Federal Acquisition Regulations. Individual government agencies and state contracts may have additional terms and conditions. Generally our contracts are subject to termination at the convenience of the U.S. Government or the state. However, in the event that a contract is terminated by the respective government, we would be eligible to be reimbursed for our allowable costs up to the time of termination and would be paid a proportionate amount of the stipulated profit attributable to the work actually performed. Although U.S. Government or state contracts may extend for several years, they are generally funded on an annual basis, or incrementally for shorter time periods, and are subject to reduction or cancellation in the event of changes in U.S. Government or state requirements due to appropriations or budgetary concerns. In addition, if the federal or state government curtail expenditures for research, development and consulting activities, the curtailment could have a material adverse impact on our revenue and earnings.

BUSINESS DEVELOPMENT

We also have a central business development group, which is aligned with our operating units and is charged with identifying and winning significant new business opportunities. Our business development group operates with disciplined processes and information systems that provide transparency to pipeline and bid status. Our business development account managers are experienced and well trained in the solutions we offer. The business development group also maintains a proposal development and publication capability.

COMPETITION

The Federal government is one of the largest purchasers of management consulting, engineering and information technology consulting services in the world. The market of suppliers of these services is diverse and fragmented. As a result we compete and collaborate with a large number of companies, as either a prime or subcontractor. Depending on the specific market or competitive opportunity our competition may include (i) other contractors and consulting firms focused primarily on providing services to the federal government, such as CACI International, Inc., NCI Inc., ICF International, SRA International, Inc., Booz Allen Hamilton, Inc. and Science Applications International Corporation; (ii) divisions of large defense contractors such as Lockheed Martin Corporation, General Dynamics Corporation and Northrop Grumman Corporation; (iii) divisions of consulting firms such as Computer Sciences Corporation and Deloitte Consulting LLP; and (iv) a broad base of smaller companies specializing in specific markets, often receiving advantages under U.S. Small Business Administration programs. Other than the small businesses most of the firms against which we compete are far larger and have far greater resources than we have.

We believe our competitive advantage is that we offer our clients similar people, processes and capabilities as the larger firms with the responsiveness of a smaller company.

The Department of Defense advisory and assistance services represent approximately 8% of the Company's business. Procurements for this work are increasingly being restricted to small businesses. Also, strengthening the acquisition capabilities of the government's workforce is a federal priority and the primary driver of federal in-sourcing (i.e. conversion of jobs performed by contractors to government employee positions) initiatives. In this market the Company competes as a subcontractor with small businesses and generally is seen by customers as having outstanding capabilities and qualifications. However, this market is price competitive, which can be a disadvantage when competing with small businesses.

GOVERNMENT REGULATION

As a defense contractor, we are subject to many levels of audit and review, including by the Defense Contract Audit Agency, the Defense Contract Management Agency, the various inspectors general, the Defense Criminal Investigative Service, the Government Accountability Office, the Department of Justice and Congressional committees. These audits and reviews could result in the termination of contracts, the imposition of fines or penalties, the withholding of payments due to us or the prohibition from participating in certain U.S. Government contracts for a specified period of time. Any such action could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Governmental awards of contracts are subject to regulations and procedures that require formal bidding procedures and allow for protests by losing bidders. Such protests may result in significant delays in the commencement of expected contracts, the reversal of a previous award or the reopening of the competitive-bidding process, which could have a material adverse effect upon our business, financial condition, results of operations and cash flows.

Compliance with federal, state and local provisions relating to the protection of the environment has not had and is not expected to have a material effect upon our capital expenditures, earnings or competitive position.

EMPLOYEES

Our customers value the skills of our employees. We believe our compensation and benefit plans are competitive within our industry, and we develop the skills of our employees through formal training and certification programs. Our workforce is highly educated with 37% of our employees holding graduate level degrees or above. Our staff holds more than 150 professional certifications, including more than 50 certified Project Management Professionals.

As of December 31, 2010, we had approximately 1,300 employees. Approximately 70% of our employees hold federal government security clearances. Nearly all of our employees are located in the United States. We require all employees to annually complete training on compliance subjects. None of our employees are represented by a labor union or subject to a collective bargaining agreement.

PROPRIETARY INFORMATION

Patents, trademarks and copyrights are not materially important to our business. The U.S. Government and state government have certain proprietary rights in software processes and data developed by us in our performance of government and state contracts.

SEASONALITY

Our business is not seasonal. However, it is not uncommon for federal government agencies to award extra tasks or complete other contract actions in the weeks before the end of the federal government's fiscal year (which is September 30) in order to avoid the loss of unexpended fiscal year funds. Additionally, in years when the federal government does not complete its budget process before the end of its fiscal year, such as in 2010, government operations typically are funded pursuant to a continuing resolution that authorizes agencies of the federal government to continue to operate, but traditionally does not authorize new spending initiatives. When much of the federal government operates under a continuing resolution, delays can occur in procurement of products and services that can affect our revenue and profit during the period of delay.

FINANCIAL DATA AND OTHER INFORMATION

Financial data and other information can be found in the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Part II, Item 7 and in Part II, Item 8 of this Form 10-K. Unless otherwise indicated, all financial information contained in this Form 10-K refers to continuing operations.

We maintain an Internet site at <http://www.drc.com>. Our Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K and all amendments to these reports are available free of charge through our website by clicking on the "Investor Relations" page and selecting "SEC Filings". The public may read and copy any materials we file with the Securities and Exchange Commission at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may also obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site (<http://www.sec.gov>) that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC. We do not intend that the information contained on our website be deemed a part of this Form 10-K or to be deemed filed with the SEC.

ITEM 1A. RISK FACTORS

In addition to the other information in this Form 10-K, readers should carefully consider the risks described below before deciding to invest in shares of our common stock. These are risks and uncertainties we believe are most important for you to consider. Additional risks and uncertainties not presently known to us, or which we currently deem immaterial, or which are similar to those faced by other companies in our industry or business in general, may also impair our business operations. If any of the following risks or uncertainties actually occurs, our business, financial condition, results of operations or cash flows would likely suffer. In that event, the market price of our common stock could decline.

Our Revenue is Highly Dependent on the Federal Government. Changes in Federal Spending Priorities or Policies Could Adversely Affect Our Results.

During 2010 and 2009, approximately 93% and 91%, respectively, of our total revenue was derived from U.S. Government agencies. Certain individual programs account for a significant portion of our U.S. Government business. We cannot provide any assurance that any of these programs will continue at current levels. Our revenue could be adversely affected by significant changes in federal spending priorities or policies such as:

- decreases in spending by agencies or programs we support;
- changes in funding priorities within the U.S. Government;
- replacement of professional services contractors with federal employees (i.e., in-sourcing);
- federal government shutdowns due to weather, security threats, lack of budget funding or other reasons;
- delays in payment of our invoices due to policy changes or problems with government information systems;
- failure of Congress to timely pass sufficient appropriations to fund our programs;
- increased allocation of federal contracts to small minority-owned or disadvantaged businesses;
- failure of Congress to continue funding of programs that extend over multiple fiscal years;
- diversion of funds to pay for international conflicts or reconstruction; or
- DoD Base realignment and closures.

It is not possible for us to predict whether federal budgets will increase or decline in the future. As a result, changes in federal priorities or policies may have adverse effects on our business, financial condition or results of operations.

We Must Bear the Risk of Various Pricing Structures Associated With Government Contracts.

We derive most of our revenue from contracts and subcontracts with the U.S. Government. A significant portion of our federal and state government contracts are undertaken on a time and materials nature, with fixed hourly rates that are intended to cover salaries, benefits, other indirect costs of operating the business and profit. Our time and material contracts represented 32% and 42% of total revenue in 2010 and 2009, respectively. The pricing of these contracts is based upon estimates of future salaries and costs and assumptions as to the aggregate volume of business that we will perform in a given business division or other relevant unit.

We undertake various government projects on a fixed-price basis. Our revenues earned under fixed price contracts have increased as a percentage of total revenues to approximately 47% in 2010 from 40% in 2009. Under a fixed-price contract, the government pays an agreed upon price for our services or products, and we bear the risk that increased or unexpected costs may reduce our profits or cause us to incur a loss.

Significant cost overruns can occur if we fail to:

- adequately estimate the resources required to complete a project;
- properly determine the scope of an engagement; or
- complete our contractual obligation in a manner consistent with the project plan.

For fixed price contracts, we must estimate the costs necessary to complete the defined statement of work and recognize revenue or losses in accordance with such estimates. Actual costs may vary materially from the estimates made from time to time, necessitating adjustments to reported revenue and net income. Underestimates of the costs associated with a project could adversely affect our overall profitability and could have a material adverse effect on our business, financial condition, results of operations and cash flows. While we endeavor to maintain and improve contract profitability, we cannot be certain that any of our existing or future fixed-price projects will be profitable.

A substantial portion of our U.S. Government business is as a subcontractor. In such circumstances, we generally bear the risk that the prime contractor will meet its performance obligations to the U.S. Government under the prime contract and that the prime contractor will have the financial capability to pay us amounts due under the subcontract. The inability of a prime contractor to perform or make required payments to us could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Federal Government Contracts Contain Provisions Giving Government Customers a Variety of Rights that are Unfavorable to Us, Including the Ability to Terminate a Contract at Any Time for Convenience.

Federal government contracts contain provisions and are subject to laws and regulations that give the government rights and remedies not typically found in commercial contracts. These provisions may allow the government to, among other things:

- terminate existing contracts for convenience, as well as for default;
- reduce orders under, or otherwise modify contracts or subcontracts;
- cancel multi-year contracts and related orders if funds for contract performance for any subsequent year become unavailable;
- decline to exercise an option to renew a multi-year contract;
- suspend or debar us from doing business with the federal government or with a governmental agency;
- prohibit future procurement awards with a particular agency as a result of a finding of an organizational conflict of interest based upon prior related work performed for the agency that would give a contractor an unfair advantage over competing contractors;
- subject the award of contracts to protest by competitors, which may require the contracting federal agency or department to suspend our performance pending the outcome of the protest; and
- claim rights in products and systems produced by us.

If the government terminates a contract for convenience, we may recover only our incurred or committed costs, settlement expenses and profit on work completed prior to the termination. If the government terminates a contract for default, we may not recover even those amounts and instead may be liable for excess costs incurred by the government in procuring undelivered items and services from another source. Due to current budgetary pressures to decrease federal spending, there may be an increased likelihood that funding may be terminated or reduced in one or more programs in which we participate, which may result in a greater number of contractual terminations for convenience. If one of our government customers were to unexpectedly terminate, cancel or decline to exercise an option to renew one or more of our significant contracts or programs, our revenues and operating results would be materially harmed.

An Increased Focus on Elimination of Overhead Within DoD May Adversely Affect Our Results.

Our revenue from contracts with the DoD, either as a prime contractor or subcontractor, accounted for approximately 66% and 61% of our total revenue in 2010 and 2009, respectively. In May 2010, the DoD began a comprehensive effort to increase efficiencies, reduce overhead costs and eliminate redundant functions in order to improve the effectiveness of the DoD enterprise. This includes a direction from the Secretary of Defense to reduce defense overhead by over \$100 billion over the next five years, as well as the announcement of a number of initiatives that may have a significant impact on the environment under which the DoD and its contractors may contract. These initiatives may result in changes to the DoD's contracting models, as well as decreases in spending on infrastructure systems and other areas where we provide services to DoD and its contractors. These initiatives continue to evolve and the implementation of these budgetary measures and other initiatives are not yet complete. The impact of these measures and initiatives on our business is uncertain, and depending on how they are implemented, they may have a negative impact on our business, financial condition and results of operations.

Our Contracts and Subcontracts with Government Agencies Are Subject to a Competitive Bidding Process. We May Be Unsuccessful in Re-Competition for Work We Are Currently Performing.

Most of our federal and state government contracts are renewable on an annual basis, or are subject to the exercise of contractual options. Multi-year contracts often require funding actions by the U.S. Government, a state legislature or others on an annual or more frequent basis. As a result, our business could experience material adverse consequences should such funding actions or other approvals not be taken.

We operate in a highly competitive market, and routinely we must compete to re-win work we are currently performing. On all of these re-competitions there exists reasonable possibility that we will not be the winner, in which event future revenues, operating results and cash flows could be materially adversely affected.

Governmental awards of contracts are subject to regulations and procedures that permit formal bidding procedures and protests by losing bidders. Such protests may result in significant delays in the commencement of expected contracts, the reversal of a previous award decision or the reopening of the competitive bidding process, which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Federal Government In-Sourcing Could Result in Loss of Business Opportunities and Personnel.

The federal government has continued to reduce the percentage of contracted services in favor of more federal employees through an initiative called “in-sourcing.” Over time in-sourcing could have a materially adverse affect on the Company’s business, financial condition and results of operations. Specifically, as a result of in-sourcing federal procurements for services could be fewer and smaller in the future. In addition, work DRC currently performs could be in-sourced by the federal government and as a result, the Company’s revenues could be reduced. Moreover, DRC employees working on contracts could also be hired by the government. This loss of DRC employees would necessitate the need to retain new employees. Accordingly, the effect of in-sourcing could have a materially adverse affect on the Company’s business, financial condition and results of operations over time.

During 2010, we lost 81 billable positions to the government’s in-sourcing and related cost reduction initiatives. While the Department of Defense has announced a discontinuation of in-sourcing, we anticipate the in-sourcing initiatives will continue, and these may result in additional in-sourcing of an estimated 20 positions in the first quarter of 2011. In total, we continue to project the total affect of the government’s in-sourcing initiative to exceed 100 positions, equating to annualized revenue of approximately \$15 million.

Inability to Hire or the Loss of Personnel Could Limit Our Growth.

We are dependent on our ability to attract and retain highly skilled technical personnel. Many of our technical personnel may have specific knowledge and experience related to various government customer operations and these individuals would be difficult to replace in a timely fashion. In addition, qualified technical personnel are in high demand worldwide and are likely to remain a limited resource. The loss of services of personnel could impair our ability to perform required services under some of our contracts, to retain this business after the expiration of the existing contract, or to win new business in the event that we lost the services of individuals who have been identified in a given proposal as key personnel in the proposal. Any of these situations could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Our Failure to Obtain and Maintain Necessary Security Clearances May Limit Our Ability to Perform Classified Work for Government Clients, Which Could Harm Our Business.

Some government contracts require us to maintain facility security clearances, and require some of our employees to maintain individual security clearances. If our employees lose or are unable to obtain security clearances on a timely basis, or we lose a facility clearance, the government client can terminate the contract or decide not to renew the contract upon its expiration. As a result, to the extent that we cannot obtain the required security clearances for our employees working on a particular contract, or we fail to obtain them on a timely basis or fail to maintain these security clearances, we may not derive the revenue anticipated from the contract, which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Security Breaches in Sensitive Government Systems Could Harm Our Business.

Many of the systems we develop, install and maintain involve managing and protecting information involved in intelligence, national security and other sensitive or classified government functions. A security breach in one of these systems could cause serious harm to our business, damage our reputation and prevent us from being eligible for further work on sensitive or classified systems for federal government clients. We could incur losses from a security breach that could exceed the policy limits under our errors and omissions and product liability insurance. Damage to our reputation, limitations on our eligibility for additional work or other losses we incur resulting from a security breach in one of our systems could have a material adverse effect on our business, financial condition, results of operations and cash flows.

The Failure by Congress to Approve Budgets on a Timely Basis for the Federal Agencies We Support Could Delay Procurement of Our Services and Solutions and Cause Us to Lose Future Revenues.

On an annual basis, Congress must approve budgets that govern spending by the federal agencies that we support. In years when Congress is not able to complete its budget process before the end of the federal government's fiscal year on September 30, Congress typically funds government operations pursuant to a continuing resolution. A continuing resolution allows federal government agencies to operate at spending levels approved in the previous budget cycle. The U.S. Government is currently operating under such a continuing resolution until March 4, 2011, and there can be no assurance that spending levels will be maintained after that date. When the U.S. Government operates under a continuing resolution, it may delay funding we expect to receive from clients on work we are already performing and will likely result in new initiatives being delayed or in some cases cancelled. Resulting delays in the collection of accounts receivable or delays or cancellations of existing projects could have a materially adverse impact on our business, financial condition, results of operations and cash flows.

Failure to Maintain Strong Relationships with Other Contractors Could Result in a Decline in Our Revenues.

In 2010 and 2009, we derived 27% and 29% of our revenues, respectively, from contracts in which we acted as a subcontractor to other contractors or to joint ventures that we and other contractors formed to bid on and execute particular contracts or programs. We expect to continue to depend on relationships with other contractors for a portion of our revenues for the foreseeable future. Our business, prospects, financial condition or operating results could be harmed if other contractors eliminate or reduce their subcontracts or joint venture relationships with us because they choose to establish relationships with our competitors; they choose to directly offer services that compete with our business; the government terminates or reduces these other contractors' programs; or the government does not award them new contracts.

Many of Our Federal Government Customers Execute Their Procurement Budgets Through Multiple Award Contracts Under Which We Are Required to Compete for Post-Award Orders, Potentially Limiting Our Ability to Win New Contracts and Increase Revenue.

Changes in the federal procurement process have caused many U.S. Government customers to increasingly purchase goods and services through multiple award ID/IQ contracts and other multiple award and/or government-wide acquisition contract vehicles.

These contract vehicles require that we make sustained post-award efforts to obtain task orders under the relevant contract. There can be no assurance that we will obtain revenues or otherwise sell successfully under these contract vehicles. Our failure to compete effectively in this procurement environment could harm our operating results.

Our inability to win re-competitions of the multiple award contracts we currently hold could have a material adverse effect on future revenues, operating results and cash flows. Also our inability to win newly competed multiple award schedule contracts, which we do not currently hold, may impede our ability to grow.

We May Lose Revenue and Our Cash Flow and Profitability Could Be Negatively Affected if Expenditures Are Incurred Prior to Final Receipt of a Contract or Contract Funding Modification.

We provide professional services and sometimes procure materials on behalf of our government clients under various contract arrangements. From time to time, in order to ensure that we satisfy our clients' delivery requirements and schedules, we may elect to initiate procurements or provide services in advance of receiving formal contractual authorization from the government client or a prime contractor. If our government client or prime contractor requirements should change or the government directs the anticipated procurement to a contractor other than us, or if the materials become obsolete or require modification before we are under contract for the procurement, our investment might be at risk. If we do not receive the required funding, our cost of services incurred in excess of contractual funding may not be recoverable. This could reduce anticipated revenue or result in a loss, negatively affecting our cash flow and profitability.

We May Be Liable for Systems and Service Failures.

We create, implement and maintain IT and technical services solutions that are often critical to our customers' operations, including those of federal, state and local governments. We may in the future experience some systems and service failures, schedule or delivery delays and other problems in connection with our work. If our solutions, services, products or other applications have significant defects or errors, are subject to delivery delays or fail to meet our customers' expectations, we may:

- lose revenues due to adverse customer reaction;
- be required to provide additional services to a customer at no charge or a discount;
- receive negative publicity that could damage our reputation and adversely affect our ability to attract or retain customers; and
- suffer claims for substantial damages against us.

In addition to any costs resulting from product warranties, contract performance or required corrective action, these failures may result in increased costs or loss of revenues if they result in customers postponing subsequently scheduled work, canceling contracts or failing to renew contracts.

While many of our contracts with the federal government limit our liability for damages that may arise from negligence in rendering services to our customers, we cannot be sure that these contractual provisions will protect us from liability for damages if we are sued. Even if unsuccessful, these claims could result in significant legal and other costs that may be a distraction to our management and/or may harm our reputation.

If We Fail to Comply with Complex Procurement Laws and Regulations, We Could Lose Business and Be Subject to Various Penalties or Sanctions.

We must comply with laws and regulations relating to the formation, administration and performance of federal government contracts. These laws and regulations affect how we conduct business with our federal government contracts. In complying with these laws and regulations, we may incur additional costs. Non-compliance may also allow for the assignment of additional fines and penalties, including contractual damages. Among the more significant laws and regulations affecting our business are the following:

- the Federal Acquisition Regulation, which comprehensively regulates the formation, administration and performance of federal government contracts;
- the Truth in Negotiations Act, which requires certification and disclosure of all cost and pricing data in connection with contract negotiations;
- the Cost Accounting Standards and Cost Principles, which impose accounting requirements that govern our right to reimbursement under certain cost-based federal government contracts;
- laws, regulations and executive orders restricting the use and dissemination of information classified for national security purposes and the export of certain products, services and technical data; and
- U.S. export controls, which apply when we engage in international work.

Failure to comply with these control regimes can lead to severe penalties, both civil and criminal, and can include debarment from contracting with the U.S. Government.

Our contracting agency customers periodically review our performance under and compliance with the terms of our federal government contracts. If a government review or investigation uncovers improper or illegal activities, we may be subject to civil or criminal penalties or administrative sanctions, including:

- termination of contracts;
- forfeiture of profits;
- cost associated with triggering of price reduction clauses;
- suspension of payments;
- fines; and
- suspension or debarment from doing business with federal government agencies.

Additionally, the civil False Claims Act provides for potentially substantial civil penalties where, for example, a contractor presents a false or fraudulent claim to the government for payment or approval. Actions under the civil False Claims Act may be brought by the government or by other persons on behalf of the government, who may then share a portion of any recovery.

If we fail to comply with these laws and regulations, we may also suffer harm to our reputation, which could impair our ability to win awards of contracts in the future or receive renewals of existing contracts. If we are subject to civil and criminal penalties and administrative sanctions or suffer harm to our reputation, our current business, future prospects, financial condition or operating results could be materially harmed.

The government may also revise its procurement practices or adopt new contracting rules and regulations, including cost accounting standards, at any time. Any new contracting methods could be costly to satisfy, be administratively difficult for us to implement and could impair our ability to obtain new contracts.

Our Contracts and Administrative Processes and Systems Are Subject to Government Regulations, Audits and Cost Adjustments By the Federal Government, Which Could Reduce Our Revenue, Disrupt Our Business or Otherwise Adversely Affect Our Results of Operations.

Federal government agencies, including the Defense Contract Audit Agency (“DCAA”), the Defense Contract Management Agency, various inspectors general, the Defense Criminal Investigative Service, the Government Accountability Office and the Department of Justice, routinely audit and investigate government contracts and government contractors’ administrative processes and systems. These agencies review our performance on contracts, pricing practices, cost structure and compliance with applicable laws, regulations and standards. They also review our compliance with government regulations and policies and the adequacy of our internal control systems and policies, including our purchasing, accounting, estimating, compensation and management information processes and systems. Any costs found to be improperly allocated to a specific contract will not be reimbursed, and any such costs already reimbursed must be refunded and certain penalties may be imposed.

DCAA audits for costs incurred on work performed after December 31, 2004 have not yet been completed. In addition, DCAA audits for costs incurred by our recent acquisitions for certain periods prior to acquisition have not yet been finalized.

An unfavorable outcome of an audit by the DCAA or another government agency may adversely affect our financial results. Moreover, if any of the administrative processes and systems are found not to comply with requirements, we may be subjected to increased government scrutiny and approval that could delay or otherwise adversely affect our ability to compete for or perform contracts or collect our revenue in a timely manner. Such possibilities include that:

- we would be required to reimburse the government for amounts previously received;
- our pricing on contracts may be prospectively reduced;
- payments to us may be significantly delayed or withheld; and
- our ability to compete may be impaired by negative audit reports or by the failure to receive audit reports.

If a government investigation uncovers improper or illegal activities, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeitures of profits, suspension of payments, fines and suspension or debarment from doing business with the federal government. In addition, we could suffer serious reputational harm if allegations of impropriety were made against us.

Each of these results could cause actual results to differ materially and adversely from those anticipated. We do not know the outcome of pending or future audits.

Our Markets are Highly Competitive, and Many of the Companies We Compete Against Have Substantially Greater Resources.

The markets in which we operate include a large number of participants and are highly competitive. Many of our competitors may compete more effectively than we can because they are larger, better financed and better known companies than we are. In order to stay competitive in our industry, we must also keep pace with changing technologies and client preferences. If we are unable to differentiate our services from those of our competitors, our revenue may decline. In addition, our competitors have established relationships among themselves or with third parties to increase their ability to address client needs. As a result, new competitors or alliances among competitors may emerge and compete more effectively than we can. There is also a significant industry trend towards consolidation, which may result in the emergence of companies who are better able to compete against us. The results of these competitive pressures could cause our actual results to differ materially and adversely from those anticipated.

Our Failure to Adequately Protect Our Confidential Information and Proprietary Rights May Harm Our Competitive Position.

Our success depends, in part, upon our ability to protect our proprietary information and other intellectual property. Although our employees are subject to confidentiality obligations, this protection may be inadequate to deter misappropriation of our confidential information. In addition, we may be unable to detect unauthorized use of our intellectual property in order to take appropriate steps to enforce our rights. If we are unable to prevent third parties from infringing or misappropriating our copyrights, trademarks or other proprietary information, our competitive position could be harmed and our actual results could differ materially and adversely from those anticipated.

Loss of Our Position as a Qualified Contractor Under One or More General Services Administration Schedules, Would Impair Our Operating Results and Our Ability to Keep Our Existing Business or Win New Business.

If we were to lose any of our GSA schedules or our prime contractor position on any of our contracts, we could lose revenues, and our ability to win new business and our operating results could decline as a result.

A Preference for Minority-Owned, Small and Small Disadvantaged Businesses Could Impact Our Ability to be a Prime Contractor on Certain Governmental Procurements.

As a result of the Small Business Administration, ("SBA"), set-aside program, the federal government may decide to restrict certain procurements only to bidders that qualify as minority-owned, small or small disadvantaged businesses. As a result, we would not be eligible to perform as a prime contractor on those programs and in general would be restricted to no more than 49% of the work as a subcontractor on those programs. An increase in the amount of procurements under the SBA set-aside program may impact our ability to bid on new procurements as a prime contractor or restrict our ability to re-compete on incumbent work that is placed in the set-aside program.

If Our Employees Engage in Misconduct or Other Improper Activities, Our Business Could Be Harmed.

We are exposed to the risk that employee fraud or other misconduct could occur. Misconduct by employees could include intentional failures to comply with federal government procurement regulations, engaging in unauthorized activities or falsifying time records. Employee misconduct could also involve the improper use of our

clients' sensitive or classified information, which could result in regulatory sanctions against us and serious harm to our reputation. It is not always possible to deter employee misconduct, and the precautions we take to prevent and detect this activity may not be effective in controlling unknown or unmanaged risks or losses, which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We Are Involved in Litigation and Other Regulatory Matters Which, If Not Resolved in Our Favor, Could Harm Our Business.

We are involved in litigation matters which could have a material adverse effect on our business, financial position, results of operations and cash flow.

As a defense contractor, DRC is subject to many levels of audit and review from various government agencies, including the Defense Contract Audit Agency, various inspectors general, the Defense Criminal Investigation Service, the Government Accountability Office, the Department of Justice and Congressional committees. Both related to and unrelated to its defense industry involvement, DRC is, from time to time, involved in audits, lawsuits, claims, administrative proceedings and investigations. We accrue for liabilities associated with these activities when it becomes probable that future expenditures will be made and such expenditures can be reasonably estimated. Except as noted below, we do not presently believe it is reasonably likely that any of these matters would have a material adverse effect on our business, financial position, results of operations or cash flows. Our evaluation of the likelihood of expenditures related to these matters is subject to change in future periods, depending on then current events and circumstances, which could have material adverse effects on our business, financial position, results of operations and cash flows.

On June 28, 2005, a class action employee suit was filed in the U.S. District Court for the District of Massachusetts alleging violations of the Fair Labor Standards Act and certain provisions of Massachusetts General Laws. In July 2010, DRC and the plaintiff agreed upon principle terms of settlement, the cost of which was accrued on the balance sheet as of June 30, 2010. In October 2010, we received an executed settlement agreement by the plaintiff. The Federal District Court for the First Circuit has reviewed the settlement and the parties are expecting the court's approval in the first quarter of 2011. Failure to obtain such approval may materially adversely affect our financial position and results of operations.

In September 2009, the IRS completed its examination of our tax returns for 2004 through 2007 and issued a Revenue Agent Report, which reduced the deferral of income for tax reporting purposes. As a result DRC reclassified approximately \$1.0 million from deferred to current taxes payable. The IRS report also included an assessment of interest of \$0.5 million. DRC has filed a protest with the IRS to appeal the assessment and has made no provision for the interest associated with the assessment. If the appeal is not successful, DRC will be required to record a reserve for the interest payable, which could adversely affect our cash flows and financial position.

We Operate in Highly Competitive Markets and May Have Difficulties Entering New Markets.

The government contracting business is subject to intense competition from numerous companies. The principal competitive factors are prior performance, previous experience, technical competence and price. In our efforts to enter new markets and attract new customers, we generally face significant competition from other companies that have prior experience with such potential customers. As a result, we may not achieve the level of success that we expect in our efforts to enter such new markets.

We May Be Subject to Product Liability Claims.

Certain components sold by DRC are generally designed to operate as important elements of complex systems or products. Defects in our products could cause our customer's product or systems to fail or perform below expectations. Although we attempt to contractually limit our liability for such defects or failures, we cannot assure you that our attempts to limit our liability will be successful. As such, we may be subject to claims for alleged performance issues related to our products. Such claims, if made, could damage our reputation and could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Our Financing Requirements May Increase and We Could Have Limited Access to Capital Markets.

Over the last several years, United States and worldwide capital and credit markets have experienced significant price volatility, dislocations and liquidity disruptions, which have caused market prices of many stocks to fluctuate substantially and the spreads on prospective debt financings to widen considerably. While we believe that our current resources and access to capital markets are adequate to support operations over the near term and foreseeable future, we cannot assure you that these circumstances will remain unchanged. Our need for capital is dependent on operating results and may be greater than expected. Our ability to maintain our current sources of debt financing depends on our ability to remain in compliance with covenants contained in our financing agreements, including, among other requirements, maintaining a minimum total net worth and minimum cash flow and debt coverage ratios. If changes in capital markets restrict the availability of funds or increase the cost of funds, we may be required to modify, delay or abandon some of our planned expenditures, which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Our Operating Results May Vary Significantly From Quarter to Quarter and Such Fluctuations May Affect the Price of Our Common Stock.

Our revenue and earnings may fluctuate from quarter to quarter depending on a number of factors, including:

- the number, size and timing of client projects commenced and completed during a quarter;
- contract wins and losses;
- changes to existing contracts made by our customers;
- bid and proposal efforts undertaken;
- progress on fixed-price projects during a given quarter;
- employee productivity and hiring, attrition and utilization rates;
- rapid changes in demand from our precision manufacturing customers;
- accuracy of estimates of resources required to complete ongoing projects;
- the trend in interest rates; and
- general economic conditions.

We May Not Make or Complete Future Mergers, Acquisitions or Strategic Alliances or Investments Which May Adversely Affect Our Growth. Additionally, Acquired Operations May Perform at Levels Below Our Financial Projections or We May Be Unable to Successfully Integrate the Acquired Operations.

We intend to continue to expand our operations through mergers, acquisitions or strategic alliances with businesses that will complement our existing business. However, we may not be able to find attractive candidates, or enter into acquisitions on terms that are favorable to us, or successfully integrate the operations of companies that we acquire. In addition, we may compete with other companies for these acquisition candidates, which could make an acquisition more expensive for us.

If we are able to successfully identify and complete an acquisition or similar transaction, it could involve a number of risks, including, among others:

- the difficulty of assimilating the acquired operations and personnel;
- the potential disruption of our ongoing business and diversion of resources and management time;
- the potential failure to retain key personnel of the acquired business;
- the difficulty of integrating systems, operations and cultures; and
- the potential impairment of relationships with customers as a result of changes in management or otherwise arising out of such transactions.

We cannot assure that any acquisition will be made, that we will be able to obtain financing needed to fund any acquisitions and, if any acquisitions are so made, that the acquired business will be successfully integrated into our operations or that the acquired business will perform as expected. In addition, if we were to proceed with one or more significant strategic alliances, acquisitions or investments in which the consideration consists of cash, a substantial portion of our available cash could be used to consummate the strategic alliances, acquisitions or

investments. The financial impact of acquisitions, investments and strategic alliances could have a material adverse effect on our business, financial condition, results of operations and cash flows and could cause substantial fluctuations in our quarterly and annual operating results.

The Company Has Substantial Investments in Recorded Goodwill as a Result of Prior Acquisitions, and Changes in Future Business Conditions Could Cause These Investments to Become Impaired, Requiring Substantial Write-Downs That Would Reduce the Company's Operating Income.

As of December 31, 2010, goodwill accounted for \$97.6 million, or approximately 49%, of the Company's recorded total assets. Under generally accepted accounting principles, the Company reviews its goodwill for impairment annually or when events or changes in circumstances indicate the carrying value may not be recoverable. A significant and sustained decrease in expected reporting unit cash flows or changes in market conditions would increase the risk of impairment of recorded goodwill. If goodwill becomes impaired, the Company would record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill is determined, which may significantly reduce or eliminate our profits.

The Market Price of Our Common Stock May Be Volatile.

The stock market in recent years has experienced significant price and volume fluctuations that often have been unrelated or disproportionate to the operating performance of particular companies. Many factors that have influenced trading prices will vary from period to period, including:

- decreases in our earnings and revenue or quarterly operating results;
- changes in estimates by analysts;
- repurchases of our common stock under our share repurchase program, pursuant to which we are authorized to purchase up to 700,000 shares of our common stock through June 6, 2011, under which 40,400 shares have been repurchased to date;
- market conditions in the industry;
- announcements and new developments by competitors; and
- regulatory reviews.

Any of these events could have a material adverse effect on the market price of our common stock. In addition, low trading volume in our common stock may cause volatility in stock price.

We are Subject to Changes in United States and Global Market Conditions That Are Beyond Our Control and May Have a Material Effect on Our Business and Results of Operations.

The United States and global economies are currently experiencing a period of substantial economic uncertainty with wide-ranging effects. The Company is unable to predict the impact, severity, and duration of these economic events, which could have a material effect on the Company's consolidated financial position, results of operations, or cash flows. If there is a downturn in the market, DRC may be required to make a larger than expected contribution to its legacy pension plan fund to enable the pension plan fund to meet its obligations to plan participants, which in turn could have an adverse impact on the Company's cash flow and liquidity.

ITEM 1B. UNRESOLVED STAFF COMMENTS

We have not received any written comments from the staff of the Securities and Exchange Commission regarding our periodic or current reports that (1) were issued not less than 180 days before the end of our 2010 fiscal year, (2) remain unresolved and (3) we believe are material.

ITEM 2. PROPERTIES

As of December 31, 2010 we leased all of the facilities used in our operations totaling approximately 454,000 square feet, of which we subleased approximately 178,000 square feet. We have principal offices in Andover, Massachusetts and in the Washington, D.C. area. We believe that our facilities are adequate for our current needs.

ITEM 3. LEGAL PROCEEDINGS

As a defense contractor, we are subject to many levels of audit and review from various government agencies, including the Defense Contract Audit Agency, Defense Contract Management Agency, various inspectors general, the Defense Criminal Investigation Service, the Government Accountability Office, the Department of Justice and Congressional committees. Both related to and unrelated to our defense industry involvement, we are, from time to time, involved in audits, lawsuits, claims, administrative proceedings and investigations. We accrue for liabilities associated with these activities when it becomes probable that future expenditures will be made and such expenditures can be reasonably estimated.

We are a party to or are subject to litigation and other proceedings referenced in Note 15 of our “Notes to Consolidated Financial Statements” in Part II, Item 8 of this Form 10-K. Except as noted therein we do not presently believe it is reasonably likely that any of these matters would have a material adverse effect on our business, financial position, results of operations or cash flows.

Our evaluation of the likelihood of expenditures related to these matters is subject to change in future periods, depending on then-current events and circumstances, which could have material adverse effects on our business, financial position, results of operations and cash flows.

ITEM 4. [REMOVED AND RESERVED]

PART II

ITEM 5. MARKET FOR RESISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is traded on the NASDAQ Global Market under the symbol "DRCO". The following table sets forth, for the periods indicated, the high and low sale prices per share of our common stock, as reported by the NASDAQ Global Market. These market quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions.

	<u>High</u>	<u>Low</u>
Fiscal year ended December 31, 2010		
First quarter	\$11.88	\$ 9.92
Second quarter	\$14.31	\$ 9.79
Third quarter	\$10.69	\$ 8.58
Fourth quarter	\$14.10	\$10.10
Fiscal year ended December 31, 2009		
First quarter	\$ 9.00	\$ 5.86
Second quarter	\$10.61	\$ 6.80
Third quarter	\$14.32	\$10.01
Fourth quarter	\$13.80	\$ 9.36

As of February 25, 2011, there were 508 shareholders of record of our common stock.

Dividend Policy

We did not declare any cash dividends in the two years ended December 31, 2010 and do not intend to in the near future. Our present policy is to retain earnings and preserve cash for our future growth and development of our business. In addition, our financing arrangements, as described in Note 8 of our "Notes to Consolidated Financial Statements" in Part II, Item 8 of this Form 10-K, restrict our ability to pay dividends.

Recent Sales of Unregistered Securities

We did not issue or sell any securities in 2010 that were not registered under the Securities Act of 1933.

Issuer Purchases of Equity Securities

The following table sets forth all purchases made by us or on our behalf by any "affiliated purchaser," as defined in Rule 10b-18(a)(3) under the Exchange Act, of shares of our common stock during each month in the fourth quarter of 2010.

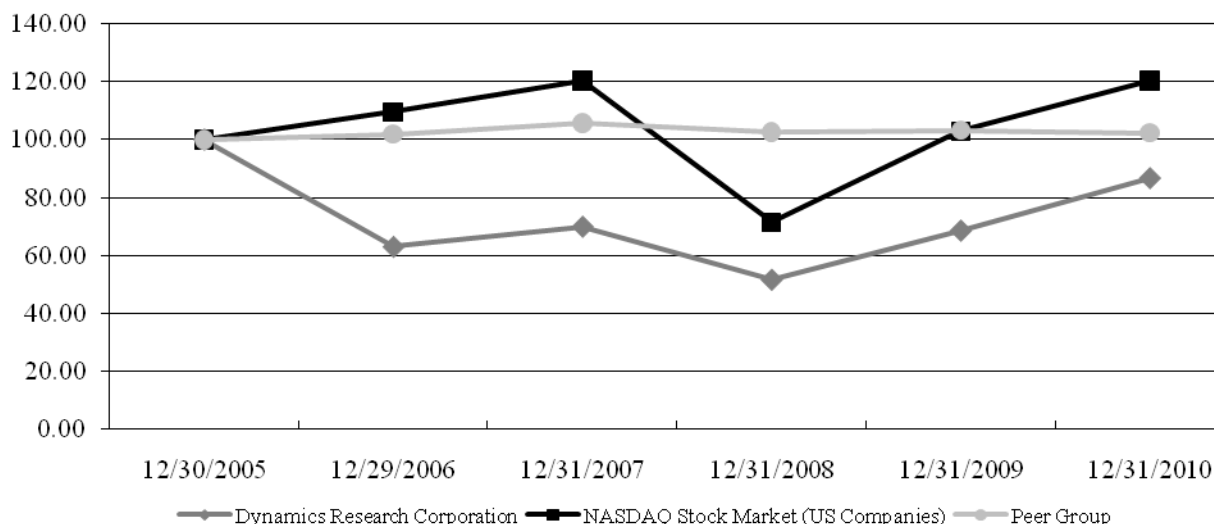
<u>Period</u>	<u>Total Number of Shares Purchased⁽¹⁾</u>	<u>Average Price Paid Per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Programs</u>	<u>Approximate Dollar Value of Shares that May Yet Be Purchased Under the Programs (in millions)</u>
October 1, 2010 to October 31, 2010	8,293	\$ 11.14	-	\$ -
November 1, 2010 to November 30, 2010	1,016	\$ 11.49	-	-
December 1, 2010 to December 31, 2010	40,400	\$ 13.60	40,400	8.8
Total	49,709	\$ 13.15	40,400	\$ 8.8

(1) During the month of December, we repurchased 40,400 shares under a repurchase program approved by our Board of Directors that was publically announced on December 6, 2010. Overall, the Board of Directors authorized the repurchase of 700,000 shares. At December 31, 2010, there were 659,600 shares remaining under the repurchase program which shares may be repurchased through June 6, 2011. The approximate dollar value of shares available to be repurchased was calculated using DRC's stock price of \$13.40 at December 31, 2010. The remaining shares repurchased in the months of October and November represented shares repurchased to cover option costs in connection with the exercise of stock options and payroll withholding taxes in connection with the vesting of restricted stock awards.

Stock Performance Graph

The following graph compares the cumulative total stockholder return on our common stock from December 30, 2005 to December 31, 2010 with the cumulative total return of (i) the NASDAQ Composite U.S. Index and (ii) our industry peers. This graph assumes the investment of \$100.00 at the closing price on December 30, 2005 in our common stock, the NASDAQ Composite U.S. Index and our industry peers, and assumes any dividends are reinvested.

**Comparison of 5 Year Cumulative Total Return
Assumes Initial Investment of \$100**



	December 31,					
	2005	2006	2007	2008	2009	2010
Dynamics Research Corporation	\$100.00	\$ 63.11	\$ 70.03	\$ 51.78	\$ 68.67	\$ 86.73
NASDAQ Stock Market (US Companies)	\$100.00	\$109.52	\$120.27	\$ 71.51	\$102.89	\$120.29
Peer Group	\$100.00	\$101.95	\$105.79	\$102.53	\$103.28	\$102.38

The performance in the above graph is not necessarily indicative of future stock price performance. Our peer group consists of industry peers with which we compete, including, CACI International, Inc., Global Defense Technology and Systems, Inc., ICF International, Inc., ManTech International Corp., NCI, Inc., SAIC, Inc., SRA International, Inc. and VSE Corp.

ITEM 6. SELECTED FINANCIAL DATA

The selected condensed consolidated financial data set forth below should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included as Part II, Item 7 of this Form 10-K, and our consolidated financial statements and notes thereto included in Part II, Item 8 of this Form 10-K. The historical results provided below are not necessarily indicative of future results.

	Year Ended December 31,				
	2010	2009	2008 ⁽¹⁾	2007	2006
<i>(dollars in thousands, except per share data)</i>					
Revenue	\$272,065	\$268,661	\$236,796	\$224,676	\$252,890
Gross profit	\$ 43,890	\$ 44,967	\$ 38,994	\$ 37,160	\$ 33,914
Operating income (loss)	\$ 20,815	\$ 17,908	\$ (150)	\$ 13,104	\$ 7,507
Income (loss) from continuing operations	\$ 12,313	\$ 10,313	\$ (1,084)	\$ 7,413	\$ 3,578
Income (loss) from discontinued operations	392	(141)	(171)	(311)	410
Cumulative benefit of accounting change	-	-	-	-	84
Net income (loss)	<u>\$ 12,705</u>	<u>\$ 10,172</u>	<u>\$ (1,255)</u>	<u>\$ 7,102</u>	<u>\$ 4,072</u>
Earnings (loss) per share - Basic					
Income (loss) from continuing operations before cumulative effect of accounting change	\$ 1.24	\$ 1.08	\$ (0.11)	\$ 0.79	\$ 0.39
Income (loss) from discontinued operations	0.04	(0.02)	(0.02)	(0.03)	0.05
Cumulative benefit of accounting change	-	-	-	-	0.01
Net earnings (loss) per share - Basic	<u>\$ 1.28</u>	<u>\$ 1.06</u>	<u>\$ (0.13)</u>	<u>\$ 0.76</u>	<u>\$ 0.45</u>
Earnings (loss) per share - Diluted					
Income (loss) from continuing operations before cumulative effect of accounting change	\$ 1.22	\$ 1.06	\$ (0.11)	\$ 0.77	\$ 0.38
Income (loss) from discontinued operations	0.04	(0.02)	(0.02)	(0.03)	0.04
Cumulative benefit of accounting change	-	-	-	-	0.01
Net earnings (loss) per share - Diluted	<u>\$ 1.26</u>	<u>\$ 1.04</u>	<u>\$ (0.13)</u>	<u>\$ 0.74</u>	<u>\$ 0.43</u>
Net cash provided by operating activities from continuing operations					
Capital expenditures	\$ 4,449	\$ 5,185	\$ 1,973	\$ 1,676	\$ 1,887
Depreciation	\$ 3,564	\$ 2,987	\$ 2,961	\$ 2,869	\$ 2,837
EBITDA ⁽²⁾	\$ 26,373	\$ 24,891	\$ 5,466	\$ 19,404	\$ 13,742

	As of December 31,				
	2010	2009	2008 ⁽¹⁾	2007	2006
<i>(dollars in thousands, except per share data)</i>					
Total assets	\$ 198,216	\$ 203,601	\$ 208,930	\$ 149,953	\$ 159,852
Total debt	\$ 22,000	\$ 31,973	\$ 38,000	\$ 7,737	\$ 15,000
Other long-term liabilities	\$ 27,067	\$ 31,936	\$ 30,286	\$ 8,576	\$ 12,805
Stockholders’ equity	\$ 107,185	\$ 94,096	\$ 81,475	\$ 96,504	\$ 84,314
Return on invested capital ⁽³⁾	12.8%	8.8%	(0.1)%	7.7%	4.9%
Stockholders’ equity per share ⁽⁴⁾	\$ 10.68	\$ 9.48	\$ 8.42	\$ 10.15	\$ 9.05
Return on stockholders’ equity ⁽⁵⁾	11.9%	10.8%	(1.5)%	7.4%	4.8%
Funded backlog	\$ 133,516	\$ 158,518	\$ 146,619	\$ 115,155	\$ 91,884
Number of shares outstanding	10,040,029	9,923,357	9,674,512	9,509,849	9,314,962

(1) Amounts include results of operations of Kadix (acquired August 1, 2008) for the period subsequent to our acquisition.

- (2) Earnings before interest, taxes, depreciation and amortization, or EBITDA, is defined as GAAP income from continuing operations plus net interest expense, income taxes, depreciation expense and amortization expense. EBITDA as calculated by us may be calculated differently than EBITDA for other companies. We have provided EBITDA because it is a component of our debt covenants calculations and we believe it is a commonly used measure of financial performance in comparable companies and is provided to help investors evaluate performance and to enhance investors' understanding of our operating results. EBITDA should not be construed as an alternative measure of net income, income from continuing operations or cash flows. Reconciliation of net income to EBITDA is as follows:

<i>(in thousands)</i>	Year Ended December 31,				
	2010	2009	2008	2007	2006
Net income (loss)	\$12,705	\$10,172	\$(1,255)	\$ 7,102	\$ 4,072
Loss (income) from discontinued operations	(392)	141	171	311	(410)
Cumulative benefit of accounting change	-	-	-	-	(84)
Income (loss) from continuing operations	12,313	10,313	(1,084)	7,413	3,578
Interest expense, net	1,084	2,024	1,423	1,541	2,042
Provision (benefit) for income taxes	7,871	6,262	(454)	4,979	2,476
Depreciation expense	3,564	2,987	2,961	2,869	2,837
Amortization expense	1,541	3,305	2,620	2,602	2,809
EBITDA	<u>\$26,373</u>	<u>\$24,891</u>	<u>\$ 5,466</u>	<u>\$19,404</u>	<u>\$13,742</u>

- (3) Return on invested capital is calculated by dividing operating income, net of related income taxes, by the ending invested capital. Invested capital is the sum of outstanding debt and stockholders' equity, minus cash, normalized for the investment made for acquisitions during the year.
- (4) Stockholders' equity per share is calculated by dividing ending stockholders' equity by the number of shares outstanding at the end of the period.
- (5) Return on stockholders' equity is calculated by dividing net income by ending stockholders equity.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read together with the consolidated financial statements and the notes to those statements that appear elsewhere in this Annual Report on Form 10-K. This discussion contains forward-looking statements that involve risks, uncertainties and assumptions, such as statements of our plans, objectives, expectations and intentions. Our actual results could differ materially from those anticipated in the forward-looking statements. Factors that could cause or contribute to our actual results differing materially from those anticipated include, but are not limited to, those discussed in "Risk Factors" in Part 1, Item 1A and elsewhere in this Form 10-K.

OVERVIEW

Dynamics Research Corporation, headquartered in Andover, Massachusetts, is a leading provider of innovative management consulting, engineering, and information technology services and solutions to federal and state governments.

Our go-to-market strategy is sharply focused within each of four dimensions:

- **Solutions.** We deliver high-value differentiated solutions to our clients. Our five areas of differentiated expertise are business transformation, information technology, training and performance support, management services and engineering services. We believe our solutions align well with the needs of our government customers today through improved efficiencies and effectiveness, procurement reform, transformational and technology based changes, and ongoing, changing security threats.
- **Markets and Customers.** We target markets, which based on long-term market force drivers, have sustained government projected demand for services. We select customers from the spectrum of federal government departments and agencies in our target growth markets with needs that well match the solutions we provide. Currently our target growth markets include homeland security, healthcare, cyber security, intelligence and financial/regulatory reform. In 2010 approximately 60% of our revenue was derived from clients in these markets and selected high growth areas of defense such as unmanned aerial systems and force readiness and training. Our 2010 revenue derived from these markets grew 12% over 2009.
- **Prime Government and Agency-Wide Contracts.** We hold an enviable portfolio of government and agency-wide multiple award schedule ID/IQ task order contracts. Today, these types of contracts are the federal government's preferred means of procurement for services.
- **Acquisitions.** We use acquisitions, funded through both operationally generated cash and leverage, to strengthen our position in our target growth markets.

During the second quarter of 2010, we sold our Metrigraphics business division which was classified as held for sale at December 31, 2009 and accounted for as a discontinued operation. Our financial results were restated to reflect the discontinuation of Metrigraphics for all periods presented prior to the sale.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

There are specific business risks to the industries in which we operate. These risks include: estimates of costs to complete contract obligations, changes in government policies and procedures, government contracting issues and risks associated with technological development. The preparation of financial statements 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. Estimates and assumptions also affect the amount of revenue and expenses during the reported period. Actual results could differ from those estimates.

Management bases its estimates on historical experience and various other assumptions it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about carrying values of assets and liabilities. The use of alternative estimates and assumptions and changes in business strategy or market conditions may significantly impact our assets or liabilities, and potentially result in a different impact to our results of operations. We believe the following critical accounting policies affect the more significant accounting areas particularly those that involve judgments, estimates and assumptions used in the preparation of our consolidated financial statements.

Revenue Recognition

We provide services pursuant to time and materials, cost reimbursable and fixed-price contracts, including service-type contracts.

For time and materials contracts, revenue reflects the number of direct labor hours expended in the performance of a contract multiplied by the contract billing rate, as well as reimbursement of other billable direct costs. The risk inherent in time and materials contracts is that actual costs may differ materially from negotiated billing rates in the contract, which would directly affect operating income.

For cost reimbursable contracts, revenue is recognized as costs are incurred and includes a proportionate amount of the fee earned. Cost reimbursable contracts specify the contract fee in dollars or as a percentage of estimated costs. The primary risk on a cost reimbursable contract is that a government audit of direct and indirect costs could result in the disallowance of some costs, which would directly impact revenue and margin on the contract. Historically, such audits have not had a material impact on our revenue and operating income.

Revenue from service-type fixed-price contracts is recognized ratably over the contract period or by other appropriate output methods to measure service provided, and contract costs are expensed as incurred. Under fixed-price contracts, other than service-type contracts, revenue is recognized primarily under the percentage of completion method. The risk on a fixed-price contract is estimates of costs to complete the contract may exceed revenues on the contract.

From time to time, we may proceed with work based on client direction prior to the completion and signing of formal contract documents. We have a formal review process for approving any such work. Revenue associated with such work is recognized only when it can reliably be estimated and realization is probable. We base our estimates on a variety of factors, including previous experiences with the client, communications with the client regarding funding status, and our knowledge of available funding for the contract.

For all types of contracts, we recognize anticipated contract losses as soon as they become known and estimable. Out-of-pocket expenses that are reimbursable by the customer are included in revenue and cost of revenue.

Unbilled receivables are the amounts of recoverable revenue that have not been billed at the balance sheet date. Unbilled receivables relate principally to revenue that is billed in the month after services are performed. In certain instances, billing is deferred in compliance with the contract terms, such as milestone billing arrangements and withholdings, indirect rate approvals or other reasons. Costs related to certain U.S. Government contracts, including applicable indirect costs, are subject to audit by the government. Revenue from such contracts has been recorded at amounts we expect to realize upon final settlement.

Goodwill and Other Intangible Assets

With the acquisition of Kadix and other businesses, we acquired goodwill and other intangible assets. The identification and valuation of these intangible assets and the determination of the estimated useful lives at the time of acquisition, as well as the completion of annual impairment tests, require significant management judgments and estimates. These estimates are based on, among other things, consultations with an accredited independent valuation consultant and reviews of projected cash flows.

We estimate fair value for our annual goodwill impairment test by employing different methodologies, including a comparison to comparable industry companies, discounted cash flows and market value, which are then weighted to arrive at an estimated fair value. The determination of relevant comparable industry companies impacts our assessment of fair value. Should the operating performance of our reporting unit change in comparison to these companies or should the valuation of these companies change, this could impact our assessment of the fair value of the reporting unit. Our discounted cash flow analysis factors in assumptions on revenue and expense growth rates. These estimates are based upon our historical experience and projections of future activity, factoring in customer demand, changes in technology and a cost structure necessary to achieve the related revenues. Additionally, the discounted cash flow analysis factors in expected amounts of working capital and weighted average cost of capital. The market value factor is primarily driven by the underlying value of our common stock, which can vary significantly depending upon a number of factors, such as overall market conditions and our estimated future profitability. Changes in judgments on any of these factors could materially impact the value of the reporting unit.

Our annual impairment test is based on several qualitative and quantitative factors. Principally, a significant and sustained decrease in expected reporting unit cash flows or changes in market conditions would increase the risk of impairment of recorded goodwill.

We operate in the government IT consulting marketplace which has historically been characterized by high visibility of future revenue streams, profitability and generally consistent positive cash flows. Our federal government customer base mitigates against near term volatility in financial performance experienced by companies operating in other parts of the economy. Long-term industry trends and other business considerations, such as those outlined in the Risk Factors section of our Form 10-K can have a favorable or unfavorable effect on future cash flows. These trends and business considerations include our concentration of business with the Federal Government, competitive bidding for contracts, and the mix of contract types in which we enter. We considered our low short-term volatility, favorable long-term industry trends, high visibility for future revenue and cash flow and stock price as context for the determination that disclosure of heightened risk relative to goodwill impairment was not necessary at the time of our filing.

As a result of the annual impairment test performed as of November 30, 2010, we determined that the carrying amount of the reporting unit did not exceed its fair value and, accordingly, did not record a charge for impairment. However, we are unable to assure that goodwill will not be impaired in subsequent periods. As of December 31, 2010, we had recorded goodwill and other intangible assets of \$100.2 million in the Consolidated Balance Sheets.

Income Taxes and Deferred Taxes

Tax provisions are completed based on the asset and liability method. As part of our process of preparing consolidated financial statements, management is required to estimate the provision for income taxes, deferred tax assets and liabilities and future taxable income for purposes of assessing our ability to realize any future benefits from deferred taxes. This process involves estimating the current tax liability and assessing temporary and permanent differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in the Consolidated Balance Sheets. We had a net deferred liability of \$1.8 million at December 31, 2010 compared to a \$2.8 million at December 31, 2009.

We recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from these positions are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate resolution. We review our tax positions on a quarterly basis and more frequently as facts surrounding tax positions change. Based on these future events, we may recognize uncertain tax positions or reverse current uncertain tax positions which would affect the statement of operations and/or the balance sheet.

We must also assess the likelihood that our deferred tax asset will be recovered from future taxable income and, to the extent a recovery is not likely, a valuation allowance must be established. At December 31, 2010, we determined that a valuation allowance was not required.

Pension Obligations

Accounting and reporting for our pension plan requires the use of assumptions, including the discount rate and expected rate of return on assets. These assumptions are used by independent actuaries to determine the value of our pension obligations and allocate this cost to the service periods. The actuarial assumptions used to calculate pension costs are determined and reviewed annually by management after consulting with outside investment advisors and actuaries.

The assumed discount rate, which is intended to be the actual rate at which benefits could effectively be settled, is determined by a spot-rate yield curve method. The spot-rate yield curve is employed to match the plan assets cash outflows with the timing and amount of the expected benefit payments. As of December 31, 2010, the pension plan's measurement date, the weighted average discount rate used to determine the benefit obligations and the net periodic benefit costs was 5.25% and 5.75%, respectively. A decrease of 50 basis points in the discount rate would have resulted in an increase in annual pension expense by approximately \$0.1 million.

The assumed expected rate of return on plan assets, which is the average return expected on the funds invested or to be invested to provide future benefits to pension plan participants, is determined by an annual review of historical long-term asset returns and consultation with outside investment advisors. The weighted average expected rate of return for 2010 was 8.50%. A decrease of 50 basis points in the expected rate of return would have resulted in an increase in annual pension expense by approximately \$0.3 million.

If assumptions differ materially from actual results in the future, our obligations under the pension plan could also differ materially, potentially requiring us to record an additional pension liability and record additional pension costs. An actuarial valuation of the pension plan is performed each year. The results of this actuarial valuation are reflected in the accounting for the pension plan upon determination. At December 31, 2010 and 2009, we recorded a pension liability of \$20.7 million and \$21.5 million, respectively, in the Consolidated Balance Sheet that represented the underfunded benefit obligation.

Litigation, Commitments and Contingencies

We are subject to a range of claims, lawsuits and administrative proceedings that arise in the ordinary course of business. Estimating liabilities and costs associated with these matters requires judgment and assessment based upon professional knowledge and experience of management and its internal and external legal counsel. Amounts are recorded as charges to earnings when management, after taking into consideration the facts and circumstances of each matter, including any settlement offers, has determined that it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. The ultimate resolution of any such exposure to us may vary from earlier estimates as further facts and circumstances become known.

RESULTS OF OPERATIONS

Operating results and results expressed as a percentage of total revenues are as follows:

<i>(in millions)</i>	Year Ended December 31,					
	2010		2009		2008	
Revenue	\$272.1		\$268.7		\$236.8	
Gross profit	\$ 43.9	16.1 %	\$ 45.0	16.7 %	\$ 39.0	16.5 %
Selling, general and administrative	21.5	7.9 %	23.8	8.8 %	36.5	15.4 %
Amortization of intangible assets	1.5	0.6 %	3.3	1.2 %	2.6	1.1 %
Operating Income (loss) ⁽¹⁾	20.8	7.7 %	17.9	6.7 %	(0.1)	(0.1)%
Interest expense, net	(1.1)	(0.4)%	(2.0)	(0.8)%	(1.4)	(0.6)%
Other income, net	0.5	0.2 %	0.7	0.3 %	0.0	0.0 %
Provision (benefit) for income taxes ⁽²⁾	7.9	39.0 %	6.3	37.8 %	(0.5)	29.5 %
Gain (loss) on discontinued operations	0.4	0.1 %	(0.1)	(0.1)%	(0.2)	(0.1)%
Net income (loss) ⁽¹⁾	<u>\$ 12.7</u>	4.7 %	<u>\$ 10.2</u>	3.8 %	<u>\$ (1.3)</u>	(0.5)%

(1) Totals may not add due to rounding.

(2) The percentage for provision (benefit) for income taxes relate to a percentage of income before provision for income taxes.

Revenue

Total revenue increased by \$3.4 million, or 1.3% in 2010 compared to 2009, and \$31.9 million, or 13.5% in 2009 compared to 2008. Revenues were earned from the following sectors:

<i>(in millions)</i>	Year Ended December 31,					
	2010		2009		2008	
National defense and intelligence agencies	\$179.7	66.1%	\$163.2	60.8%	\$162.0	68.4%
Homeland security	50.5	18.5	54.6	20.3	19.4	8.2
Federal civilian agencies ⁽¹⁾	23.9	8.8	26.5	9.9	29.4	12.4
Total revenue from federal agencies	254.1	93.4	244.3	90.9	210.8	89.0
State and local government agencies	17.9	6.6	24.0	8.9	25.6	10.8
Other	0.1	0.0	0.3	0.1	0.5	0.2
Total revenue ⁽¹⁾	<u>\$272.1</u>	<u>100.0%</u>	<u>\$268.7</u>	<u>100.0%</u>	<u>\$236.8</u>	<u>100.0%</u>

(1) Totals may not add due to rounding.

Federal agency revenue increased \$9.8 million, or 4.0% in 2010 compared to 2009, and \$33.5 million, or 15.9% in 2009 compared to 2008. Federal agency revenues derived from our target growth markets were the primary reason for the increase in total revenues in 2010. Currently our target growth markets include homeland security, healthcare, cyber security, intelligence and financial/regulatory reform. In 2010 approximately 60% of our revenue was derived from clients in these markets and selected high growth areas of defense such as unmanned aerial systems and force readiness and training. Our 2010 revenue derived from these markets grew 12% over 2009.

During 2010, the increase in federal agency revenues from our target growth markets were partially offset by a loss of billable positions to the government's in-sourcing and related cost reduction initiatives. During 2010, we lost 81 billable positions to the government's in-sourcing and related cost reduction initiatives. While the Department of Defense has announced a discontinuation of in-sourcing, we anticipate the in-sourcing initiatives will continue, and these may result in additional in-sourcing of an estimated 20 positions in the first quarter of 2011. In total, we continue to project the total affect of the government's in-sourcing initiative to exceed 100 positions, equating to annualized revenue of approximately \$15 million, of which approximately half was realized in 2010 results and the remainder is to be reflected in 2011 results.

The increase in 2009 federal agency revenue compared to 2008 was due a full year of Kadix revenue, supplemented by new contracts and task orders received in the second half of 2008 and in 2009. Revenue from federal agencies grew 3.7% excluding the effect of acquisitions in 2009 compared with 2008, which is calculated by adding the first seven months of Kadix 2008 revenue of \$24.7 million to our reported 2008 federal agency revenue. Growth in our target markets in 2009 was partially offset by the roll-off of 8(a) set aside contracts, lower Air Force small business set aside revenue under the Consolidated Acquisition of Professional Services contract and lower revenue related to the U.S. Navy Trident Missile Program.

The decrease in revenues from state and local government agencies in 2010 compared to 2009 was due to the deployment of the State of Tennessee child welfare system contract in September 2010. The decrease in 2009 compared to 2008 was due to the completion of the State of Ohio contract in 2009, partially offset by increased revenues from the State of Tennessee contract which began in the second quarter of 2008. Revenues from the State of Tennessee contract were \$5.2 million in 2010 compared to \$14.3 million in 2009 and \$7.0 million in 2008.

Revenues by contract type as a percentage of revenues were as follows:

	Year Ended December 31,		
	2010	2009	2008
Fixed price, including service type contracts	47%	40%	33%
Time and materials	32	42	49
Cost reimbursable	21	18	18
	<u>100%</u>	<u>100%</u>	<u>100%</u>
Prime contract	73%	71%	63%
Sub-contract	27	29	37
	<u>100%</u>	<u>100%</u>	<u>100%</u>

Prime contract revenues increased in 2010 compared to prior periods as a result of an increasing portion of contracts awarded under DRC's agency-wide multiple award schedule ID/IQ contracts.

Indefinite Contract Awards

The preferred means by which the government procures services today is through indefinite contract awards, commonly referred as agency-wide ID/IQ contracts. Occasionally, these contracts are issued to a single provider but most often they are issued for multiple years to multiple vendors. The majority of our revenue is derived from these contracts. We hold a broad portfolio of these prime contracts, including the following:

<u>Market</u>	<u>Sponsoring Agency</u>	<u>M/S⁽¹⁾</u>	<u>Contract Name</u>
Government Wide	General Services Administration	M	Alliant
Government Wide	Office of Personnel Management	M	Training and Management Assistance (TMA)
Homeland Security	Department of Homeland Security	M	Enterprise Acquisition Gateway to Leading Edge (EAGLE)
Homeland Security	Department of Homeland Security	M	Professional Program Management Services/Solutions (PPMSS)
Financial/Regulatory	Department of Treasury	M	Treasury Information Processing Support Services (TIPSS IV)
Financial/Regulatory	Federal Deposit Insurance Corporation	S	Business Analysis Management Support Services (BAMSS)
Healthcare	TRICARE (Department of Defense)	M	Evaluation, Analysis, Management & Support (TEAMS)
Intelligence	Maryland Procurement Office	S	BajaSands
Readiness	Army Training and Doctrine Command	M	Simulation & Training Omnibus Contract (STOC II)
Readiness	Army Research Institute	M	Research, Development & Analysis in Army Training (TRAIN II)
Readiness	Department of Defense	M	Logistics Management Support Services (LMSS)
Readiness	U.S. Air Force	M	Enterprise Integration Services Management (NETCENTS EISM)
Readiness	U.S. Air Force	M	Design Engineering Support Program (DESP II)

The EAGLE, PPMSS, BAMSS and DESP II contracts are currently under re-competition for successor contract vehicles. Individual contracts and contract task orders, which are subject to re-competition in 2011 total \$68 million in annual revenue. We believe we are well positioned to win successor contracts in each circumstance. However, the outcomes from the competitions remain uncertain, and there can be no assurance of award of successor contracts to DRC.

Backlog and Bookings

Our backlog position was as follows:

<i>(in millions)</i>	Year Ended December 31,		
	2010	2009	2008
Backlog:			
Funded	\$133.5	\$158.5	\$146.6
Unfunded	267.4	276.0	211.0
Total	<u>\$400.9</u>	<u>\$434.5</u>	<u>\$357.6</u>
Funded Bookings	<u>\$272.1</u>	<u>\$282.3</u>	<u>\$262.8</u>

Funded bookings generated a book-to-bill ratio of approximately 1.0 to 1 in 2010 and 1.1 to 1 in both 2009 and 2008. The ending funded backlog as of December 31, 2010, 2009 and 2008 covered approximately 5.7, 7.2 and 6.7 months of revenue, respectively. We expect that substantially all of our funded backlog at December 31, 2010 will generate revenue during the year ending December 31, 2011. The funded backlog generally is subject to possible termination at the convenience of the contracting party. Contracts are generally funded on an annual basis or incrementally for shorter time periods.

Gross Profit

Our gross profit on revenue was \$43.9 million, \$45.0 million and \$39.0 million in 2010, 2009 and 2008, respectively, resulting in a gross margin of 16.1% in 2010, 16.7% in 2009 and 16.5% in 2008. The decrease in gross profit in 2010 compared to 2009 was primarily due to lower direct labor content of revenue which resulted primarily from the government's in-sourcing initiative partially offset by indirect cost efficiencies including labor related and facilities efficiencies. The increase in gross profit in 2009 compared to 2008 was primarily due to a full year of business activity associated with Kadix revenue. The improvement in gross margin was due to the addition of higher margin services provided by the acquired Kadix operations, improved labor utilization and a shift from subcontract work to prime contract work, partially offset by an increase in pension expense due to the decline in plan asset performance in 2008. We recorded severance costs of \$0.8 million, \$1.0 million and \$1.7 million in cost of revenue in 2010, 2009 and 2008, respectively.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$21.5 million in 2010, \$23.8 million in 2009 and \$36.5 million in 2008. Selling, general and administrative expenses as a percent of total revenue was 7.9%, 8.8% and 15.4% for 2010, 2009 and 2008, respectively. During 2008, selling, general and administrative expenses included a litigation provision of \$14.8 million. Excluding the litigation provision, selling, general and administrative expenses as a percent of total revenue would have been 9.2%. The decrease in selling, general and administrative expenses in 2010 compared to 2009 was primarily due to lower legal fees, business development costs, facility costs and administrative staffing costs. The decrease in 2009 compared to 2008 was due to the litigation provision recorded in 2008, partially offset by a full year of Kadix selling, general and administrative costs and an increase in deferred compensation costs in 2009.

Amortization of Intangible Assets

Amortization expense, which relates to the amortization of acquired intangible assets, was \$1.5 million in 2010, \$3.3 million in 2009 and \$2.6 million in 2008. The decrease in amortization expense in 2010 compared to 2009

primarily relates to the intangible assets acquired from our 2004 acquisition of Impact Innovations Group which was fully amortized in the third quarter of 2009. The increase in 2009 compared to 2008 primarily relates to a full year of amortization expense recorded for the 2008 acquisition of Kadix. We anticipate 2011 amortization expense of \$1.2 million.

Interest Expense, net

We incurred net interest expense of \$1.1 million in 2010, \$2.0 million in 2009 and \$1.5 million in 2008. The decrease in interest expense in 2010 compared to 2009 was due to lower debt levels and interest rates during 2010. The increase in interest expense in 2009 compared to 2008 was due to a full year of interest expense associated with our term loan used to finance the Kadix acquisition in 2008. We recorded approximately \$0.1 million of interest income in each of the three years ended in 2010.

Other Income, net

Other income (expense) consists of our portion of earnings and losses in HMRTech, LLC, a small disadvantaged business in which we own a 40% interest, gains and losses realized from our deferred compensation plan and results from other non-operating transactions, all of which were immaterial to our results.

Provision for Income Taxes

We recorded income tax provisions of \$7.9 million in 2010 and \$6.3 million in 2009, and recorded an income tax benefit of \$0.5 million in 2008. The effective income tax rate was 39.0% in 2010 compared to 37.8% in 2009 and 39.9% in 2008, excluding the tax effect of \$5.8 million in 2008 related to the litigation provision. On April 5, 2010, we received a tax refund of \$0.3 million related to 2003 tax deductions, which we recorded in the first quarter of 2010. The 2009 effective rate was favorably affected by an adjustment to our unrecognized tax benefits and a reduction in state tax expense associated with the filing of prior year tax returns.

Loss on Discontinued Operations

As of December 31, 2009, Metrigraphics was classified as held for sale and accounted for as a discontinued operation. Effective July 19, 2010, we sold Metrigraphics for consideration of \$2.5 million. We recorded a gain from discontinued operation, net of taxes, of \$0.4 million in 2010 and a loss, net of taxes, of \$0.1 million and \$0.2 million in 2009 and 2008, respectively.

Shares Used in Computing Earnings (Loss) Per Share

Weighted average common shares outstanding and common equivalent shares totaled 10.1 million, 9.8 million and 9.5 million for the years ended December 31, 2010, 2009 and 2008, respectively. The increase in shares in 2010 compared to 2009 was due to the issuance of common stock, primarily through stock plan transactions. The increase in shares in 2009 compared to 2008 was due to the net loss recorded in 2008, which did not include the dilutive effect of stock options or unvested restricted stock.

LIQUIDITY AND CAPITAL RESOURCES

The following discussion analyzes liquidity and capital resources by operating, investing and financing activities as presented in our Consolidated Statements of Cash Flows. Our principal sources of liquidity are cash flows from operations and borrowings from our revolving credit facility.

Our results of operations, cash flows and financial condition are subject to trends, events and uncertainties, including demands for capital to support growth, economic conditions, government payment practices and contractual matters. Our need for access to funds is dependent on future operating results, our growth and acquisition activity and external conditions.

We have evaluated our future liquidity needs, both from a short-term and long-term basis. We believe we have sufficient funds to meet our working capital and capital expenditure needs for the short term. Cash on hand plus cash generated from operations along with cash available under credit lines are expected to be sufficient in 2011 to service debt, finance capital expenditures, pay federal and state income taxes and fund the pension plan, if necessary. To provide for long-term liquidity, we believe we can generate substantial positive cash flow, as well as obtain additional capital, if necessary, from the use of subordinated debt or equity. In the event that our current capital resources are not sufficient to fund requirements, we believe our access to additional capital resources would be sufficient to meet our needs.

We believe that selective acquisitions are an important component of our growth strategy. We may acquire, from time to time, firms or properties that are aligned with our core capabilities and which complement our customer base. We will continue to consider acquisition opportunities that align with our strategic objectives, along with the possibility of utilizing the credit facility as a source of financing.

At December 31, 2010 and 2009, we had cash and cash equivalents aggregating \$30.2 million and \$0.1 million, respectively.

Operating Activities

Net cash provided by operating activities from continuing operations of \$41.3 million during 2010 was primarily attributable to net earnings realized and collections on our contract receivables. Net cash provided by operating activities from continuing operations totaled \$8.2 million and \$18.6 million in 2009 and 2008, respectively.

Net contract receivables were \$48.4 million and \$72.6 million at December 31, 2010 and December 31, 2009, respectively. Billed receivables decreased \$11.1 million and \$6.4 million in 2010 and 2009, respectively. Unbilled receivables decreased \$13.2 million in 2010 and increased \$8.0 million in 2009. Contract receivables days sales outstanding ("DSO"), was 62 days at December 31, 2010 and 99 days at December 31, 2009. Federal business DSO, which excludes the effect of state contracts, was 55 days at December 31, 2010 and 73 days at December 31, 2009. The states of Ohio and Tennessee had a combined contract receivable balance outstanding of \$1.9 million and \$19.9 million at December 31, 2010 and December 31, 2009, respectively.

Our net deferred tax liability was \$1.8 million at December 31, 2010 compared to \$2.8 million at December 31, 2009. The decrease was primarily due to changes in unbilled receivables, partially offset by changes in property and equipment, the timing of pension contributions and the usage of the state net operating loss. During 2010, we paid \$6.2 million in income taxes, net of \$3.3 million in refunds, compared to \$0.5 million in 2009. In July 2010, we received \$3.0 million from a federal net operating loss carryback tax claim.

The IRS has challenged the deferral of income for tax reporting purposes related to unbilled receivables including the applicability of a Letter Ruling issued by the IRS to DRC in January 1976 which granted us deferred tax treatment of the unbilled receivables. This issue was elevated to the IRS National Office for determination. On October 23, 2008, we received a notification of ruling from the IRS National Office. This ruling provided clarification regarding the IRS position relating to revenue recognition for tax purposes regarding our unbilled receivables. During September 2009, the IRS completed its examination of our tax returns for 2004 through 2007 and issued a Revenue Agent Report, which reduced the deferral of income for tax reporting purposes. As a result we reclassified approximately \$1 million from deferred to current taxes payable. The IRS report also included an assessment of interest of \$0.5 million. We have filed a protest with the IRS to appeal the assessment. We believe the appeal will be successful and have therefore made no provision for the interest associated with the assessment.

Share-based compensation was \$0.7 million in both 2010 and 2009, and \$1.1 million in 2008. The decrease in 2009 compared to 2008 was primarily due to the vesting of Executive Long Term Incentive Program shares in the second quarter of 2008. As of December 31, 2010 the total unrecognized compensation expense related to restricted stock awards was \$0.6 million which is expected to be amortized over approximately 1.8 years, and the unrecognized compensation expense related to stock option awards was \$0.2 million which is expected to be amortized over approximately 2.5 years.

Non-cash amortization expense of our acquired intangible assets was \$1.5 million in 2010, \$3.3 million in 2009 and \$2.6 million in 2008. We anticipate that non-cash expense for the amortization of intangible assets will decrease to approximately \$1.2 million in 2011, excluding the addition of any acquisitions.

Our defined benefit pension plan was underfunded by \$20.7 million and \$21.5 million at December 31, 2010 and 2009, respectively. The decrease in the plan's underfunded status in 2010 was primarily attributable to favorable asset performance during the year and an increase in cash contributions to the plan during 2010. We recorded pension expense of \$0.8 million and \$1.6 million in 2010 and 2009, respectively, compared to pension income of \$1.3 million in 2008. The decrease in pension expense was primarily due to favorable asset performance in 2009 and an increase in cash contributions to the plan during 2010. We contributed \$3.5 million to fund the pension plan in January 2011 and anticipate pension expense to be approximately \$0.2 million in 2011.

Investing Activities

Net cash used in investing activities from continuing operations of \$2.1 million during 2010 was primarily attributable to capital expenditures, partially offset by proceeds from the sale of Metrigraphics. Net cash used in investing activities from continuing operations was \$9.0 million in 2009 and \$44.3 million in 2008.

Capital expenditures for the purchase of property and equipment were \$4.4 million, \$5.2 million and \$2.0 million in 2010, 2009 and 2008, respectively. The increase in capital expenditures in 2010 and 2009 compared to 2008 was primarily related to the move to our corporate headquarters in 2009. We expect discretionary capital expenditures in 2011 to be in the range of \$2 million to \$4 million.

During July 2010, we sold Metrigraphics for consideration of \$2.5 million, which consisted of \$1.75 million in cash and \$0.75 million in the form of a subordinated note. Interest on the subordinated note is payable quarterly and the repayment of principal is due in full in July 2012, the maturity date of the subordinated note.

In August 2008, we completed the acquisition of Kadix. The total purchase price of \$47.3 million included additional contingent consideration related to achievement of earnout objectives of \$4.3 million that was accrued at December 31, 2008 and paid in 2009.

Financing Activities

In December 2010, DRC's board of directors authorized a share repurchase program, which allows us to buy back up to 700,000 shares of our common stock through June 6, 2011. During 2010, we repurchased 40,400 shares at a weighted average price of \$13.60. The timing, price and amount of any repurchase will be determined by management based on its evaluation of market conditions and other factors. These repurchases may be made through the open market, including block purchases, or in private negotiated transactions, or otherwise. The buyback will be funded through available cash balances and or borrowings, and may be suspended or discontinued at any time. At December 31, 2010, there were 659,600 shares available to be repurchased under the program.

Our term loan requires quarterly repayments of \$2.0 million and we expect operating cash flows to be sufficient to fund these repayments. Our swap agreement effectively fixes our interest rate on an initial notional amount of \$20.0 million of the term loan principal at 5.10% (3.60% swap fixed rate plus the current margin of 1.50%) throughout the term of the credit facility. At December 31, 2010, the borrowing capacity available under our revolver was \$24.6 million. The facility and swap agreements are more fully described in Note 8 and Note 10, respectively, of our "Notes to Consolidated Financial Statements" in Part II, Item 8 on this Form 10-K.

The Company believes it has access to additional capital resources, from the use of subordinated debt or equity, as alternate sources of funding. We are confident that our current resources are sufficient and we believe the possibility of needing additional financing resources for the continuation of current operations is remote.

At December 31, 2010, the Company was in compliance with its loan covenants. The Company's most stringent financial covenant is the fixed charge coverage ratio. This covenant requires the Company to maintain a ratio of

adjusted consolidated EBITDA to adjusted consolidated interest expense of not less than 1.25 to 1.00. This fixed charge coverage ratio is tested on a quarterly basis and is measured on a trailing four fiscal quarter basis.

The average daily borrowing on our revolver for 2010 was \$1.0 million at a weighted average interest rate of 3.25%, compared to \$3.2 million at a weighted average interest rate of 3.25% in 2009 and \$3.2 million at a weighted average interest rate of 5.41% in 2008. During 2010, the average outstanding balance of our term loan was \$26 million at a weighted average interest rate of 3.76% compared to \$34.0 million at a weighted average interest rate of 4.27% in 2009 and \$40.0 million outstanding for the last five months of 2008 at a weighted average interest rate of 5.14%.

During 2010, net cash used in financing activities of \$8.9 million represented repayments under the term loan of \$8.0 million, net payments of \$2.0 million under our revolver and payments of \$0.6 million for the repurchase of shares, partially offset by proceeds of \$1.5 million from the issuance of common stock through stock plan transactions.

During 2009, net cash used in financing activities of \$5.9 million represented repayments under the term loan of \$8.0 million, partially offset by net borrowings of \$2.0 million under our revolver and proceeds of \$0.3 million from the issuance of common stock through the exercises of stock options and employee stock purchase plan transactions.

During 2008, net cash provided by financing activities of \$30.7 million represented net borrowings under the term loan of \$38.0 million and proceeds of \$0.9 million from the issuance of common stock through the exercises of stock options and employee stock purchase plan transactions, partially offset by net repayments of \$7.7 million under our revolver.

Off-Balance Sheet Arrangements

We did not utilize or employ any off-balance sheet arrangements during the three years ended December 31, 2010, defined as (i) an obligation under a guarantee contract with certain characteristics, (ii) a retained or contingent interest in assets transferred to an unconsolidated entity or similar arrangement, (iii) an obligation, including a contingent obligation, under a contract that would be accounted for as a derivative instrument but for the fact that it is indexed to the issuer's stock and classified as shareholder' equity or (iv) an obligation, including a contingent obligation, arising out of a variable interest in an unconsolidated entity.

Contractual Obligations

Our contractual obligations as of December 31, 2010 consist of the following:

	Payments Due By Period			
	Less than one year	Two to three years	Four to five years	Thereafter
<i>(in millions)</i>				
Long-term debt payments	\$ 22.0	\$ 8.0	\$ 14.0	\$ -
Interest payments	0.8	0.5	0.4	-
Operating lease payments	38.1	6.6	12.7	11.7
Total contractual obligation payments	<u>\$ 60.9</u>	<u>\$ 15.1</u>	<u>\$ 27.1</u>	<u>\$ 11.7</u>
Contractually obligated operating lease receipts	<u>\$ 9.2</u>	<u>\$ 2.3</u>	<u>\$ 3.5</u>	<u>\$ 3.5</u>

(1) Totals may not add due to rounding.

The contractual amounts above related to interest payments does not include the portion of interest contractually due on our term loan principal balance that is not tied to the interest rate swap because those interest rates are not fixed. The interest rate swap agreement effectively fixes half of the term loan's principal balance at an interest rate of 5.10%, which includes the applicable margin of 1.50% at December 31, 2010.

We may be required to make cash outlays related to our unrecognized tax benefits. However, due to the uncertainty of the timing of future cash flows associated with our unrecognized tax benefits, we are unable to make reasonably reliable estimates of the period of cash settlement, if any, with the respective taxing authorities. Accordingly, unrecognized tax benefits, including interest and penalties of \$0.6 million as of December 31, 2010, have been excluded from the contractual obligations table above. For further information on unrecognized tax benefits, see Note 7 of our “Notes to Consolidated Financial Statements” in Part II, Item 8 of this Form 10-K.

Contingencies

We are a party to litigation and other proceedings as referenced in Note 15 of our “Notes to Consolidated Financial Statements” in Part II, Item 8 on this Form 10-K. Except as noted therein we do not presently believe it is likely that any of these matters would have a material adverse effect on our business, financial position, results of operations or cash flows.

Our evaluation of the likelihood of expenditures related to these matters is subject to change in future periods, depending on then current events and circumstances, which could have material adverse effect on our business, financial position, results of operations and cash flows.

RECENT ACCOUNTING PRONOUNCEMENTS

A description of recent accounting pronouncements are referenced in Note 2 of our “Notes to Consolidated Financial Statements” in Part II, Item 8 on this Form 10-K.

IMPACT OF INFLATION AND CHANGING PRICES

Overall, inflation has not had a material impact on our operations. Additionally, the terms of DoD contracts, which accounted for approximately 66% of total revenue in 2010, are generally one year contracts and include salary increase factors for future years, reducing the potential impact of inflation.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are subject to interest rate risk associated with our revolver and term loan, where interest payments are tied to either the LIBOR or prime rate. At December 31, 2010, the interest rate on our term loan was 1.79%. We entered into an interest rate swap agreement to mitigate the floating interest rate risk on half of our outstanding term loan. The swap agreement effectively fixes the interest rate on half of our outstanding term loan at 5.10%, which includes the applicable margin of 1.50% at December 31, 2010. The blended interest rate of our term loan and swap agreement was 3.44% at December 31, 2010. At any time, a sharp rise in interest rates could have an adverse effect on net interest expense as reported in our Consolidated Statements of Operations. Our potential loss over one year that would result in a hypothetical and instantaneous increase of one full percentage point in the interest rate on half of our term loan would increase annual interest expense by approximately \$0.2 million.

In addition, historically our investment positions have been relatively small and short-term in nature. We typically invest excess cash in money market accounts with original maturities of three months or less with no exposure to market interest rates. We have no significant exposure to foreign currency fluctuations. Foreign sales, which are nominal, are primarily denominated in U.S. dollars.

PART II

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

TABLE OF CONTENTS

	<u>Page</u>
Report of Independent Registered Public Accounting Firm	44
Consolidated Balance Sheets as of December 31, 2010 and 2009	45
Consolidated Statements of Operations for the years ended December 31, 2010, 2009 and 2008	46
Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income for the years ended December 31, 2010, 2009 and 2008	47
Consolidated Statements of Cash Flows for the years ended December 31, 2010, 2009 and 2008	48
Notes to Consolidated Financial Statements	49
Schedule II — Valuation and Qualifying Accounts and Reserves	75

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and
Shareholders of Dynamics Research Corporation:

We have audited the accompanying consolidated balance sheets of Dynamics Research Corporation (a Massachusetts corporation) and subsidiaries (collectively the “Company”) as of December 31, 2010 and 2009, and the related consolidated statements of operations, changes in stockholders’ equity and comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2010. Our audits of the basic financial statements included the financial statement schedule listed in the index appearing under Item 15 (a)(2). These consolidated financial statements and the financial statement schedule are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements and the financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Dynamics Research Corporation and subsidiaries as of December 31, 2010 and 2009, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2010, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company’s internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 28, 2011 expressed an unqualified opinion thereon.

/s/ Grant Thornton LLP

Boston, Massachusetts
February 28, 2011

DYNAMICS RESEARCH CORPORATION
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	December 31,	
	2010	2009
Assets		
Current assets		
Cash and cash equivalents	\$ 30,163	\$ 55
Contract receivables, net	48,394	72,569
Prepaid expenses and other current assets	2,924	5,702
Discontinued operations	-	2,058
Total current assets	81,481	80,384
Noncurrent assets		
Property and equipment, net	12,219	13,915
Goodwill	97,641	97,641
Intangible assets, net	2,533	4,074
Deferred tax asset	585	4,252
Other noncurrent assets	3,757	3,335
Total noncurrent assets	116,735	123,217
Total assets	\$198,216	\$203,601
Liabilities and stockholders' equity		
Current liabilities		
Current portion of long-term debt	\$ 8,000	\$ 8,000
Accounts payable	16,883	18,299
Accrued compensation and employee benefits	18,046	16,357
Deferred tax liability	2,418	7,046
Other accrued expenses	4,617	3,708
Discontinued operations	-	186
Total current liabilities	49,964	53,596
Long-term liabilities		
Long-term debt	14,000	23,973
Other long-term liabilities	27,067	31,936
Total long-term liabilities	41,067	55,909
Total liabilities	91,031	109,505
Commitments and contingencies (Note 15)		
Stockholders' equity		
Preferred stock, \$0.10 par value; 5,000,000 shares authorized; no shares issued	-	-
Common stock, \$0.10 par value; 30,000,000 shares authorized; 10,040,029 and 9,923,357 shares issued and outstanding at December 31, 2010 and 2009, respectively	1,004	992
Capital in excess of par value	54,138	52,580
Accumulated other comprehensive loss, net of tax	(21,691)	(20,505)
Retained earnings	73,734	61,029
Total stockholders' equity	107,185	94,096
Total liabilities and stockholders' equity	\$198,216	\$203,601

The accompanying notes are an integral part of these consolidated financial statements.

DYNAMICS RESEARCH CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except share and per share data)

	<u>Year Ended December 31,</u>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Revenue	\$ 272,065	\$ 268,661	\$ 236,796
Cost of revenue	<u>228,175</u>	<u>223,694</u>	<u>197,802</u>
Gross profit	43,890	44,967	38,994
Selling, general and administrative expenses	21,534	23,754	36,524
Amortization of intangible assets	<u>1,541</u>	<u>3,305</u>	<u>2,620</u>
Operating income (loss)	20,815	17,908	(150)
Interest expense, net	(1,084)	(2,024)	(1,423)
Other income, net	<u>453</u>	<u>691</u>	<u>35</u>
Income (loss) from continuing operations before provision for income taxes	20,184	16,575	(1,538)
Provision (benefit) for income taxes	<u>7,871</u>	<u>6,262</u>	<u>(454)</u>
Income (loss) from continuing operations	12,313	10,313	(1,084)
Gain (loss) from discontinued operations (Note 3)	<u>392</u>	<u>(141)</u>	<u>(171)</u>
Net income (loss)	<u>\$ 12,705</u>	<u>\$ 10,172</u>	<u>\$ (1,255)</u>
Earnings (loss) per common share			
Basic			
Income (loss) from continuing operations	\$ 1.24	\$ 1.08	\$ (0.11)
Gain (loss) from discontinued operations	<u>0.04</u>	<u>(0.02)</u>	<u>(0.02)</u>
Net income (loss)	<u>\$ 1.28</u>	<u>\$ 1.06</u>	<u>\$ (0.13)</u>
Diluted			
Income (loss) from continuing operations	\$ 1.22	\$ 1.06	\$ (0.11)
Gain (loss) from discontinued operations	<u>0.04</u>	<u>(0.02)</u>	<u>(0.02)</u>
Net income (loss)	<u>\$ 1.26</u>	<u>\$ 1.04</u>	<u>\$ (0.13)</u>
Weighted average shares outstanding			
Basic	9,893,322	9,551,614	9,493,495
Diluted	10,078,937	9,772,722	9,493,495

The accompanying notes are an integral part of these consolidated financial statements.

DYNAMICS RESEARCH CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY AND COMPREHENSIVE
INCOME (LOSS)
(in thousands)

	<u>Common Stock Shares</u>	<u>Common Stock Par Value</u>	<u>Capital In Excess of Par Value</u>	<u>Accumulated Other Comprehensive Loss</u>	<u>Retained Earnings</u>	<u>Total</u>
Balance at December 31, 2007	9,510	\$ 951	\$ 50,251	\$ (6,745)	\$ 52,112	\$ 96,569
Comprehensive loss:						
Net loss	-	-	-	-	(1,255)	(1,255)
Other comprehensive loss, net of tax:						
Pension liability adjustment, net of reclassification adjustment	-	-	-	(14,896)	-	(14,896)
Reclassification adjustment for gains realized in net loss	-	-	-	(108)	-	(108)
Unrealized loss on derivative instruments	-	-	-	(519)	-	(519)
Other comprehensive loss						<u>(15,523)</u>
Comprehensive loss						(16,778)
Issuance of common stock through stock plan transactions	128	12	843	-	-	855
Issuance of restricted stock	92	9	(9)	-	-	-
Forfeiture of restricted stock	(13)	(1)	1	-	-	-
Release of restricted stock	(42)	(4)	(418)	-	-	(422)
Share-based compensation	-	-	1,148	-	-	1,148
Tax benefit from stock plan transactions	-	-	103	-	-	103
Balance at December 31, 2008	<u>9,675</u>	<u>967</u>	<u>51,919</u>	<u>(22,268)</u>	<u>50,857</u>	<u>81,475</u>
Comprehensive income:						
Net income	-	-	-	-	10,172	10,172
Other comprehensive income, net of tax:						
Pension liability adjustment, net of reclassification adjustment	-	-	-	1,587	-	1,587
Changes in unrealized loss on derivative instruments, net of reclassification adjustment	-	-	-	176	-	176
Other comprehensive income						<u>1,763</u>
Comprehensive income						11,935
Issuance of common stock through stock plan transactions, net	190	19	231	-	-	250
Issuance of restricted stock	101	10	(10)	-	-	-
Forfeiture of restricted stock	(24)	(2)	2	-	-	-
Release of restricted stock	(19)	(2)	(171)	-	-	(173)
Share-based compensation	-	-	736	-	-	736
Tax deficiency from stock plan transactions	-	-	(127)	-	-	(127)
Balance at December 31, 2009	<u>9,923</u>	<u>992</u>	<u>52,580</u>	<u>(20,505)</u>	<u>61,029</u>	<u>94,096</u>
Comprehensive income:						
Net income	-	-	-	-	12,705	12,705
Other comprehensive loss, net of tax:						
Pension liability adjustment, net of reclassification adjustment	-	-	-	(1,247)	-	(1,247)
Changes in unrealized loss on derivative instruments, net of reclassification adjustment	-	-	-	61	-	61
Other comprehensive loss						<u>(1,186)</u>
Comprehensive income						11,519
Issuance of common stock through stock plan transactions, net	171	17	1,463	-	-	1,480
Issuance of restricted stock	30	3	(3)	-	-	-
Repurchased shares	(40)	(4)	(546)	-	-	(550)
Forfeiture of restricted stock	(24)	(2)	2	-	-	-
Release of restricted stock	(20)	(2)	(219)	-	-	(221)
Share-based compensation	-	-	718	-	-	718
Tax benefit from stock plan transactions	-	-	143	-	-	143
Balance at December 31, 2010	<u>10,040</u>	<u>\$ 1,004</u>	<u>\$ 54,138</u>	<u>\$ (21,691)</u>	<u>\$ 73,734</u>	<u>\$ 107,185</u>

The accompanying notes are an integral part of these consolidated financial statements.

DYNAMICS RESEARCH CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	<u>Year Ended December 31,</u>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Cash flows from operating activities:			
Net income (loss)	\$ 12,705	\$ 10,172	\$ (1,255)
Gain (loss) from discontinued operations	392	(141)	(171)
Income (loss) from continuing operations	<u>12,313</u>	<u>10,313</u>	<u>(1,084)</u>
Adjustments to reconcile net cash provided by operating activities:			
Depreciation	3,564	2,987	2,961
Amortization of intangible assets	1,541	3,305	2,620
Share-based compensation	718	736	1,148
Investment income from equity interest	(228)	(355)	(483)
Tax benefit from stock plan transactions, net of tax deficiencies from equity awards	(143)	127	(103)
Litigation settlement (payment)	-	(15,000)	14,819
Deferred income taxes	(183)	9,362	(4,572)
Other	(507)	(637)	(620)
Change in operating assets and liabilities:			
Contract receivables, net	24,175	(1,937)	1,310
Prepaid expenses and other current assets	2,778	(3,996)	4
Accounts payable	1,151	(2,342)	3,558
Accrued compensation and employee benefits	1,689	2,713	(1,519)
Other accrued expenses	831	(2,043)	2,239
Other long-term liabilities	<u>(6,368)</u>	<u>4,975</u>	<u>(1,696)</u>
Net cash provided by continuing operations	41,331	8,208	18,582
Net cash provided by (used in) discontinued operations	<u>(161)</u>	<u>(280)</u>	<u>173</u>
Net cash provided by operating activities	<u>41,170</u>	<u>7,928</u>	<u>18,755</u>
Cash flows from investing activities:			
Purchase of business, net of cash acquired	-	(4,250)	(43,016)
Additions to property and equipment	(4,449)	(5,185)	(1,973)
Proceeds from the sale of business	1,750	-	-
Proceeds from sale of investments and long-lived assets	20	215	291
Dividends from equity investment	207	556	423
Payments related to sale of building	-	-	(35)
Change in other assets	<u>385</u>	<u>(345)</u>	<u>21</u>
Net cash used in continuing operations	(2,087)	(9,009)	(44,289)
Net cash used in discontinued operations	<u>(75)</u>	<u>(71)</u>	<u>(37)</u>
Net cash used in investing activities	<u>(2,162)</u>	<u>(9,080)</u>	<u>(44,326)</u>
Cash flow from financing activities:			
Borrowings under term loan agreement	-	-	40,000
Repayments under term loan agreement	(8,000)	(8,000)	(2,000)
Borrowings under revolving credit agreement	34,156	79,497	69,225
Repayments under revolving credit agreement	(36,129)	(77,524)	(76,962)
Proceeds from the exercise of stock plan transactions	1,480	250	855
Payments of repurchased shares	(550)	-	-
Tax benefit from stock plan transactions, net of tax deficiencies from equity awards	143	(127)	103
Payments of deferred financing costs	-	-	(545)
Net cash provided by (used in) financing activities	<u>(8,900)</u>	<u>(5,904)</u>	<u>30,676</u>
Net increase (decrease) in cash and cash equivalents	<u>30,108</u>	<u>(7,056)</u>	<u>5,105</u>
Cash and cash equivalents, beginning of period	55	7,111	2,006
Cash and cash equivalents, end of period	<u>\$ 30,163</u>	<u>\$ 55</u>	<u>\$ 7,111</u>
Supplemental disclosure of cash flow information:			
Cash paid during the year for interest	\$ 936	\$ 2,350	\$ 973
Cash paid during the year for income taxes, net of refunds	\$ 6,207	\$ 522	\$ 2,399
Supplemental disclosure of noncash financing and investing activities:			
Issuance of restricted stock	\$ 333	\$ 903	\$ 869
Increase (decrease) in pension liability	\$ 2,066	\$ (2,630)	\$ 24,682
Increase (decrease) in fair value of derivative liability	\$ (102)	\$ (291)	\$ 860
Note receivable from sale of business	\$ 750	\$ -	\$ -
Accrual of additions to property and equipment	\$ -	\$ 2,767	\$ -
Accrual of earnout on purchase of business	\$ -	\$ -	\$ 4,250

The accompanying notes are an integral part of these consolidated financial statements.

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except per share amounts)

NOTE 1. NATURE OF OPERATIONS

Dynamics Research Corporation (the “Company”) is a leading provider of innovative management consulting, engineering, technical, information technology services and solutions to federal and state governments. Founded in 1955 and headquartered in Andover, Massachusetts, the Company has approximately 1,300 employees located throughout the United States. The Company operates as a parent corporation as well as through its wholly owned subsidiaries, Kadix Systems, LLC, H.J. Ford Associates, Inc. and DRC International Corporation.

The Company provides support to its customers in the primary mission areas of information technology, logistics and readiness, cyber security and information assurance, homeland security, healthcare and intelligence and space. Customers include the Department of Defense, the Department of Homeland Security, federal civilian agencies and state governments.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation and Basis of Presentation

The consolidated financial statements include the accounts of the Company and all wholly owned subsidiaries. All significant intercompany accounts and transactions are eliminated in consolidation. Unless otherwise indicated, all dollars presented herein are in thousands and financial information refers to continuing operations. The Company has reclassified certain prior period amounts to conform with the current period presentation.

During the second quarter of 2010, the Company sold Metrigraphics which was classified as held for sale at December 31, 2009 and accounted for as a discontinued operation. The Company’s consolidated financial statements and notes thereto were restated to reflect the discontinuation of Metrigraphics for all periods presented. Refer to Note 3 for additional information regarding the sale and results of Metrigraphics.

The Company has a 40% ownership interest in HMRTech, LLC (“HMRTech”), a small disadvantaged business as defined by the Small Business Administration of the U.S. Government. This investment is accounted for using the equity method and reported as a component of other noncurrent assets in the Company’s Consolidated Balance Sheets. Refer to Note 14 for additional information regarding the Company’s ownership in HMRTech.

Risks, Uncertainties and Use of Estimates

There are risks specific to the industries in which the Company operates. These risks include, but are not limited to, estimates of costs to complete contract obligations, changes in government priorities, policies and procedures and government contracting issues. The U.S. Government has the right to terminate contracts for convenience in accordance with government regulations. If the government terminated contracts, the Company would generally recover costs incurred up to termination, costs required to be incurred in connection with the termination and a portion of the fee earned commensurate with the work performed to termination. However, significant adverse effects on the Company’s indirect cost pools may not be recoverable in connection with a termination for convenience. Contracts with state and other governmental entities are subject to the same or similar risks.

A majority of the Company’s revenue is derived from U.S. Government contracts. Cancellations, modifications, failure to win a re-competition of the Company’s contracts or subcontracts, or failure by the government to exercise option periods relating to those contracts or subcontracts, could adversely affect the Company’s business, financial condition, results of operations and cash flows. The Company could experience material adverse consequences should such actions not be taken.

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and, accordingly, include amounts based on informed estimates and judgments of management with consideration given to materiality. Estimates and judgments also affect the amount of revenue and expenses during the reported period. Actual results could differ from those estimates. The Company believes the following accounting policies affect the more significant judgments made and estimates used in the preparation of its consolidated financial statements.

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

The Company estimates and provides for potential losses that may arise out of litigation and regulatory proceedings to the extent that such losses are probable and can be estimated. Significant judgment is required in making these estimates and the Company's final liabilities may ultimately be materially different. The Company's total liability in respect of litigation and regulatory proceedings is determined on a case-by-case basis and represents an estimate of probable losses after considering, among other factors, the progress of each case or proceeding, the Company's experience and the experience of others in similar cases or proceedings, and the opinions and views of legal counsel. Given the inherent difficulty of predicting the outcome of the Company's litigation and regulatory matters, particularly in cases or proceedings in which substantial or indeterminate damages or fines are sought, the Company cannot always estimate losses or ranges of losses. Refer to Note 15 for information on the Company's litigation and other proceedings.

Revenue Recognition

The Company provides its services pursuant to time and materials, cost reimbursable and fixed-price contracts, including service-type contracts.

For time and materials contracts, revenue reflects the number of direct labor hours expended in the performance of a contract multiplied by the contract billing rate, as well as reimbursement of other billable direct costs. The risk inherent in time and materials contracts is that actual salaries and other costs may differ materially from negotiated billing rates in the contract, which would directly affect operating income.

For cost reimbursable contracts, revenue is recognized as costs are incurred and includes a proportionate amount of the fee earned. Cost reimbursable contracts specify the contract fee in dollars or as a percentage of estimated costs. The primary risk on a cost reimbursable contract is that a government audit of direct and indirect costs could result in the disallowance of certain costs, which would directly impact revenue and margin on the contract. Historically, such audits have not had a material impact on the Company's revenue and operating income.

Revenue from service-type fixed-price contracts is recognized ratably over the contract period or by other appropriate output methods to measure service provided, and contract costs are expensed as incurred. Under fixed-price contracts, other than service-type contracts, revenue is recognized primarily under the percentage of completion method. The risk on a fixed-price contract is estimates of costs to complete the contract may exceed revenues on the contract.

From time to time, the Company may proceed with work based on client direction prior to the completion and signing of formal contract documents. The Company has a formal review process for approving any such work. Revenue associated with such work is recognized only when it can reliably be estimated and realization is probable. The Company bases its estimates on a variety of factors, including previous experiences with the client, communications with the client regarding funding status, and our knowledge of available funding for the contract.

For each type of contract, the Company recognizes anticipated contract losses as soon as they become known and estimable. Out-of-pocket expenses that are reimbursable by the customer are included in revenue and cost of revenue.

Unbilled receivables are the amounts of recoverable revenue that have not been billed at the balance sheet date. Generally, the Company's unbilled receivables relate to revenue that is billed in the month after services are performed. In certain instances, billing is deferred in compliance with the contract terms, such as milestone billing arrangements and withholdings, indirect rate approvals or other reasons. Costs related to certain U.S. Government contracts, including applicable indirect costs, are subject to audit by the government. Revenue from such contracts has been recorded at amounts the Company expects to realize upon final settlement.

Cash and Cash Equivalents

The Company considers cash on deposit and all highly liquid investments with original maturities of three months or less to be cash and cash equivalents.

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

Contract Receivables

Contract receivables, net of the allowance for doubtful accounts, are stated at amounts expected to be realized in future periods. Unbilled receivables are amounts that are expected to be billed in accordance with contract terms and delivery schedules, as well as amounts expected to become billable upon final execution of contracts, contract completion, milestones or completion of rate negotiations. Generally, the Company's unbilled receivables relate to revenue that is billed in the month after services are performed. Costs related to certain U.S. Government contracts, including applicable indirect costs, are subject to audit by the government. Revenue from such contracts has been recorded at amounts the Company expects to realize upon final settlement. Contract receivables are classified as current assets in accordance with industry practice.

The allowance for doubtful accounts is determined based upon the Company's best estimate of a customer's ability to pay. The factors that influence management's estimate include historical experience, specific identification and an aging criteria of potential uncollectible accounts. The Company writes off contract receivables when such amounts are determined to be uncollectible. Losses have historically been within management's expectations.

Property and Equipment

Property and equipment, including improvements that significantly add to productive capacity or extend the asset's useful life are capitalized and recorded at cost. When items are sold, or otherwise retired or disposed of, operating income is charged or credited for the difference between the net book value and proceeds realized thereon. Repair and maintenance costs are expensed as incurred. Property and equipment is depreciated on the straight-line basis over their estimated useful lives. Estimated useful lives of production equipment typically range from three to five years, while software and furniture and other equipment typically range from three to fifteen years. Leasehold improvements are amortized over the shorter of the remaining expected term of the lease, considering renewal options if reasonably assured, or the life of the related asset. The Company recorded depreciation expense of \$3.6 million in 2010 and \$3.0 million in both 2009 and 2008. The Company recorded disposals of \$3.5 million, \$0.9 million and \$0.8 million during 2010, 2009 and 2008, respectively, of substantially fully-depreciated property and equipment no longer in use.

Internal Software Development Costs

In accounting for development costs of software to be used internally both internal and external costs incurred during the application development stage are capitalized and subsequently amortized over the estimated economic useful life of the software. These costs are included with machinery and equipment, a separate component of property and equipment.

Investments

The Company holds investments related to its deferred compensation plan. These investments, which are classified as trading securities and held in a Rabbi Trust, are carried at fair value and reported as a component of other noncurrent assets. Unrealized holding gains and losses are included in earnings as a component of other income or expense. The Company recorded net unrealized holding gains of \$0.2 million and \$0.3 million in 2010 and 2009, respectively, and recorded a net unrealized holding loss of \$0.6 million in 2008.

Business Acquisitions

The Company accounts for business acquisitions using the purchase method of accounting. The Company determines and records the fair value of assets acquired and liabilities assumed as of the dates of acquisition. The Company utilizes an independent valuation specialist to determine the fair value of identifiable intangible assets acquired in order to assist in the determination of the portion of the purchase price allocable to these assets.

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

Goodwill and Indefinite-lived Intangible Assets

Goodwill is recorded when the consideration paid for a business acquisition exceeds the fair value of net tangible and identifiable intangible assets acquired. Goodwill and other intangible assets with indefinite useful lives are not amortized, but rather, tested annually for impairment.

The Company assesses goodwill for impairment annually and when events or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value by applying a direct value-based fair value test. Goodwill could be impaired due to market declines, reduced expected future cash flows, or other factors or events. Should the fair value of goodwill at the measurement date fall below its carrying value, a charge for impairment of goodwill could occur in that period. Impairment is tested using a two-step approach. Companies must first determine whether goodwill is impaired and if so, they must value that impairment based on the amount by which the book value exceeds the estimated fair value.

The Company changed the date as of which its annual goodwill impairment analysis is performed from December 31st to November 30th. This change in timing is considered a change in accounting principle. The Company believes the new date is preferable because the timing coincides with the Company's long-range planning process and it allows the Company more time to complete the analysis prior to the date the Company reports its results for the fourth quarter. As a result of the annual impairment test performed as of November 30, 2010 and December 31, 2009, the Company determined that the carrying amount of its reporting unit did not exceed its estimated fair value and, accordingly, did not record a charge for impairment. There can be no assurance that goodwill will not become impaired in future periods.

Intangible and Other Long-lived Assets

The Company uses assumptions in establishing the carrying value, fair value and estimated lives of identifiable intangible and other long-lived assets. Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the asset carrying value may not be recoverable. Recoverability is measured by a comparison of the asset's continuing ability to generate positive income from operations and positive cash flow in future periods compared to the carrying value of the asset. If assets are considered to be impaired, the impairment is recognized in the period of identification and is measured as the amount by which the carrying value of the asset exceeds the fair value of the asset. The useful lives and related amortization of identifiable intangible assets are based on their estimated residual value in proportion to the economic benefit consumed. The useful lives and related depreciation of other long-lived assets are based on the Company's estimate of the period over which the asset will generate revenue or otherwise be used by the Company. During 2010, there were no events or changes in circumstances that required the Company to test for impairment.

Asset Retirement Obligations

The Company records the fair value of obligations to retire and/or remove long-lived assets in the period in which the obligation is incurred, typically when the asset is placed in service. When the liability is initially recorded, the Company capitalizes this cost by increasing the carrying amount of the related asset. Over time the liability is increased for the change in its present value, and the capitalized cost is depreciated over the useful life of the related asset. At December 31, 2010 and 2009, the Company recorded a long-term liability of \$0.2 million and \$0.1 million, respectively, offset by a similar increase in leasehold improvements due to a legal obligation to remove certain leasehold improvements at the Company's corporate headquarters.

Income Taxes

The Company accounts for income taxes using the asset and liability method pursuant to which deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the financial statements in the period that includes the enactment date. Valuation allowances are provided if based upon the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. The Company has considered future taxable income and ongoing prudent

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

and feasible tax planning strategies in assessing the need for the valuation allowance. In the event the Company determined it would not be able to realize all or part of its net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made. The Company determined that no valuation allowance was required at December 31, 2010 and 2009.

The Company recognizes the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from these positions are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate resolution. Interest costs and penalties related to uncertain tax positions are classified as net interest expense and selling, general and administrative costs, respectively, in the Company's financial statements. The Company reviews its tax positions on a quarterly basis and more frequently as facts surrounding tax positions change. Based on these future events, the Company may recognize uncertain tax positions or reverse current uncertain tax positions the impact of which would affect the consolidated financial statements.

Pension Obligations

The Company measures plan assets and benefit obligations as of the date of its fiscal year end. Accounting and reporting for the Company's pension plan requires the use of assumptions, including but not limited to, a discount rate and an expected return on assets. These assumptions are reviewed at least annually based on reviews of current plan information and consultation with the Company's independent actuary and the plan's investment advisor. If these assumptions differ materially from actual results, the Company's obligations under the pension plan could also differ materially, potentially requiring the Company to record an additional pension liability. An independent actuarial valuation of the pension plan is performed each year.

Deferred Financing Costs

Costs associated with obtaining the Company's financing arrangements are deferred and amortized over the term of the financing arrangements using the effective interest method.

Derivative Financial Instruments

The Company recognizes derivatives as either an asset or liability measured at its fair value. For derivatives that have been formally designated as a cash flow hedge, the effective portion of changes in the fair value of the derivatives are recorded in accumulated other comprehensive income (loss). Amounts in accumulated other comprehensive income (loss) are reclassified into earnings when interest expense on the underlying borrowings is recognized.

The Company entered into an interest rate swap agreement to manage its exposure to interest rate changes. The swap effectively converts a portion of the Company's variable rate debt under the term loan to a fixed rate, without exchanging the notional principal amounts. If, at any time, the swap is determined to be ineffective, in whole or in part, due to changes in the interest rate swap or underlying debt agreements, the fair value of the portion of the swap determined to be ineffective will be recognized as a gain or loss in the statement of operations for the applicable period.

Fair Value Measurements

The Company's financial assets and liabilities are measured at fair value which is defined as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants. Valuation techniques are based on observable or unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. These two types of inputs have created the following fair value hierarchy:

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

- Level 1 — Quoted prices for identical instruments in active markets.
- Level 2 — Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which significant value drivers are observable.
- Level 3 — Valuations derived from valuation techniques in which significant value drivers are unobservable.

The carrying values of cash and cash equivalents, contract receivables and accounts payable approximate fair value because of the short-term nature of these instruments. The carrying value of debt also approximates fair value because the interest rate is variable.

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to credit risk include accounts receivable and cash equivalents. Management believes that credit risk related to the Company's accounts receivable is limited due to a large number of customers in differing segments and agencies of the U.S. government. Accounts receivable credit risk is also limited due to the credit worthiness of the U.S. government. Management believes the credit risk associated with the Company's cash equivalents is limited due to the credit worthiness of the obligors of the investments underlying the cash equivalents. In addition, although the Company maintains cash balances at financial institutions that exceed federally insured limits, these balances are placed with high quality financial institutions.

Operating Leases

The Company's minimum operating lease payments are recognized on a straight-line basis, beginning on the date that the Company takes possession or control of the property. When the terms of an operating lease provide for periods of free rent, rent concessions or rent escalations, the Company establishes a deferred rent liability for the difference between the scheduled rent payment and the straight-line rent expense recognized. The deferred rent liability is amortized over the underlying lease term on a straight-line basis as a reduction of rent expense.

The Company had a deferred rent liability of \$4.8 million and \$5.2 million recorded as of December 31, 2010 and 2009, respectively. The long-term portions of the deferred rent liability of \$4.2 million and \$5.0 million were recorded in other long-term liabilities as of December 31, 2010 and 2009, respectively, and the remaining current portions were recorded in other accrued expenses in the accompanying balance sheets.

Restructuring Costs

Obligations associated with restructuring activities generally requires a liability for costs associated with an exit or disposal activity be recognized and measured initially at its fair value in the period in which the liability is incurred. The overall purpose of the Company's restructuring actions is to lower overall operating costs and improve profitability by reducing excess capacities. Restructuring charges are reported in the period in which the plan is approved by the Company's senior management and, where material, the Company's Board of Directors, and when the liability is incurred.

During 2008, the Company recorded a restructuring cost of \$0.7 million consisting principally of employee termination costs related to the Navy's Trident Missile program which was included in cost of revenue and paid out in full during 2009.

Comprehensive Income (Loss)

As it relates to the Company, comprehensive income (loss) is defined as net income (loss) plus other comprehensive income (loss), which is the sum of changes in the pension liability adjustments and unrealized gains and losses on investments available for sale and derivative instruments. These amounts are presented net of tax in the accompanying statements of changes in stockholders' equity and comprehensive income (loss).

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

Earnings Per Share

Basic earnings (loss) per share are computed by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share is determined by using the weighted average number of common and dilutive common equivalent shares outstanding during the period. In years in which a net loss is reported, the dilutive effect of stock options and restricted stock grants are not included in the computation as their effect would be anti-dilutive.

Restricted shares of common stock that vest based on the satisfaction of certain conditions are treated as contingently issuable shares until the conditions are satisfied. These shares are excluded from the basic earnings per share calculation and included in the diluted earnings per share calculation as the shares do not qualify as a participating security.

Share-Based Compensation

The measurement and recognition of share-based compensation expense is based on estimated fair value for all share-based payment awards including stock options, employee stock purchases under employee stock purchase plans, non-vested share awards (restricted stock) and stock appreciation rights. The Company recognizes compensation expense based on the estimated grant date fair value method using a straight-line amortization method over the vesting period of the award reduced for actual forfeitures.

Recent Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board (“FASB”) issued Accounting Standard Update (“ASU”) No. 2010-06, *Improving Disclosures about Fair Value Measurements*. The standard amends Accounting Standards Codification (“ASC”) Topic 820, *Fair Value Measurements and Disclosures*, to require additional disclosures related to transfers between levels in the hierarchy of fair value measurement. The Company adopted this standard on January 1, 2010. The standard does not change how fair values are measured; accordingly, the standard will not have an impact on the Company’s consolidated financial statements. See Note 9 for fair value measurement disclosures.

In February 2010, the FASB issued ASU No. 2010-09, *Amendments to Certain Recognition and Disclosure Requirements*. The standard amends ASC Topic 855 to address certain implementation issues related to an entities requirement to perform and disclose subsequent-event procedures. The standard requires SEC filers to “evaluate subsequent events through the date the financial statements are issued” and exempts SEC filers from disclosing the date through which subsequent events have been evaluated. The Company evaluates subsequent events through the date and time of the filing of the applicable periodic report with the SEC.

In July 2010, the FASB issued ASU No. 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. The purpose of the additional disclosures is to enable users of financial statements to better understand the nature of credit risk inherent in an entity’s portfolio of financing receivables and how that risk is analyzed. For end of period balances, the new disclosures are required to be made in all interim and annual periods ending on or after December 15, 2010. For activity during a reporting period, the disclosures are required to be made in all interim and annual periods after January 1, 2011. These changes did not have an impact on the consolidated financial statements.

NOTE 3. DISCONTINUED OPERATIONS

During 2009, the Company engaged an investment banker, and in the fourth quarter entered into a plan to sell Metrigraphics as management determined that Metrigraphics was not core to the Company’s mission and strategy. As of December 31, 2009, Metrigraphics was classified as held for sale as a discontinued operation and the Company’s consolidated financial statements and notes thereto were restated to reflect the discontinuation of Metrigraphics for all periods presented.

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

Effective July 19, 2010, the Company sold Metrigraphics for consideration of \$2.5 million, which consisted of \$1.75 million in cash and \$0.75 million in the form of a subordinated note. Interest on the subordinated note is payable quarterly and the repayment of principal is due in full on July 20, 2012, the maturity date of the subordinated note.

The operating results of Metrigraphics classified as discontinued operations are summarized below:

	<u>Year ended December 31,</u>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Product revenue	\$4,790	\$6,611	\$6,028
Gain (loss) before benefit for income taxes	\$ 806	\$ (314)	\$ (421)
(Provision) benefit for income taxes	(322)	173	250
Income (loss) from operations of discontinued operations, net of income taxes	484	(141)	(171)
Loss on sale of discontinued operations, net of income taxes	(92)	-	-
Effect of discontinued operations, net of income taxes	<u>\$ 392</u>	<u>\$ (141)</u>	<u>\$ (171)</u>

Details of balance sheet items for Metrigraphics are summarized below:

	<u>December 31,</u>
	<u>2009</u>
Accounts receivables	\$ 946
Inventory	864
Prepaid expenses and other current assets	22
Property and equipment, net	226
Total current assets	<u>\$ 2,058</u>
Accounts payable	\$ 186
Total current liabilities	<u>\$ 186</u>

NOTE 4. BUSINESS ACQUISITION

On August 1, 2008, the Company completed the acquisition of Kadix for \$42.3 million in cash including acquisition costs of \$0.4 million, plus additional consideration of \$5.0 million based on migration to the Company of services provided by Kadix under 8(a) contracts, which were stipulated for performance by minority/women owned contracts having an unrestricted status, and the achievement of anticipated 2009 gross margin targets. During 2008, additional consideration of \$5.0 million was earned and accrued as additional purchase price. Of the additional purchase price \$0.8 million was paid in 2008 and the remaining \$4.2 million was paid in the first quarter of 2009. The Company recorded \$41.5 million to goodwill and other intangible assets and believes it will be tax deductible.

The following unaudited pro forma results of operations have been prepared as though the acquisition of Kadix had occurred on January 1, 2007. These pro forma results include adjustments for interest expense and amortization of deferred financing costs on the acquisition term loan used to finance the transaction, amortization expense for the identifiable intangible asset determined in the preliminary independent appraisal and the effect of income taxes. These unaudited pro forma results do not include certain nonrecurring costs Kadix paid at the closing of the sale, including the payout for Kadix' Phantom Unit Plan and Ownership Appreciations Rights participants, professional fees related to the acquisition and discretionary bonuses. This unaudited pro forma information does not purport to be indicative of the results of operations that would have been attained had the acquisition been made as of January 1, 2007, or of results of operations that may occur in the future.

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

	Year Ended December 31, 2008
	(unaudited)
Revenue	\$ 261,540
Gross profit	\$ 48,118
Operating income	\$ 4,228
Net income	\$ 692
Earnings per share:	
Basic	\$ 0.07
Diluted	\$ 0.07

NOTE 5. SUPPLEMENTAL BALANCE SHEET INFORMATION

The composition of selected balance sheet accounts is as follows:

	December 31,	
	2010	2009
Contract receivables, net:		
Billed receivables	\$ 17,123	\$ 28,203
Unbilled receivables ⁽¹⁾ :		
Revenues recorded in excess of milestone billings on fixed price contracts with the State of Tennessee	499	18,004
Retainages and fee withholdings	394	689
Other unbilled receivables	30,899	26,256
Total unbilled receivables	31,792	44,949
Allowance for doubtful accounts	(521)	(583)
Contract receivables, net	<u>\$ 48,394</u>	<u>\$ 72,569</u>
Prepaid expenses and other current assets:		
Refundable income taxes	\$ -	\$ 1,604
Restricted cash	350	262
Other	2,574	3,836
Prepaid expenses and other current assets	<u>\$ 2,924</u>	<u>\$ 5,702</u>
Property and equipment, net:		
Software	\$ 10,834	\$ 12,107
Furniture and other equipment	8,657	9,679
Leasehold improvements	7,104	6,445
Production equipment	341	440
Property and equipment	26,936	28,671
Less accumulated depreciation	(14,717)	(14,756)
Property and equipment, net	<u>\$ 12,219</u>	<u>\$ 13,915</u>
Other noncurrent assets:		
Deferred compensation plan investments	\$ 1,589	\$ 1,378
Equity investments	999	978
Other	1,169	979
Other noncurrent assets	<u>\$ 3,757</u>	<u>\$ 3,335</u>

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

	<u>December 31,</u>	
	<u>2010</u>	<u>2009</u>
Accrued compensation and employee benefits:		
Accrued compensation and related taxes	\$ 8,487	\$ 9,029
Accrued vacation	4,008	4,724
Accrued pension liability	4,000	840
Other	1,551	1,764
Accrued compensation and employee benefits	<u>\$18,046</u>	<u>\$16,357</u>
Other accrued expenses:		
Deferred gain on sale of building	\$ 676	\$ 676
Deferred rent liability	591	206
Accrued income taxes	390	-
Other	2,960	2,826
Other accrued expenses	<u>\$ 4,617</u>	<u>\$ 3,708</u>
Other long-term liabilities:		
Accrued pension liability	\$16,694	\$20,666
Deferred rent liability	4,185	4,951
Deferred gain on sale of building	2,705	3,381
Deferred compensation plan liability	1,589	1,378
Other	1,894	1,560
Other long-term liabilities	<u>\$27,067</u>	<u>\$31,936</u>

(1) At December 31, 2010 and 2009, \$0.3 million and \$0.5 million, respectively, of unbilled retainages and fee withholdings are not anticipated to be billed within twelve months.

NOTE 6. INTANGIBLE ASSETS

Components of the Company's identifiable intangible assets are as follows:

	<u>December 31, 2010</u>			<u>December 31, 2009</u>		
	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net</u>	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net</u>
Customer relationships	\$1,900	\$ (440)	\$1,460	\$13,400	\$ (11,643)	\$1,757
Customer contracts	3,500	(2,857)	643	3,500	(2,234)	1,266
Non-competition agreements	1,400	(970)	430	1,400	(349)	1,051
8(a) contract transition	130	(130)	-	130	(130)	-
Total	<u>\$6,930</u>	<u>\$ (4,397)</u>	<u>\$2,533</u>	<u>\$18,430</u>	<u>\$ (14,356)</u>	<u>\$4,074</u>

During 2010 and 2009, the Company wrote off \$11.5 million and \$1.3 million, respectively, of fully amortized intangible assets. The Company recorded amortization expense for its identifiable intangible assets of \$1.5 million, \$3.3 million and \$2.6 million in the years ended December 31, 2010, 2009 and 2008, respectively. At December 31, 2010, estimated future amortization expense for the identifiable intangible assets to be recorded by the Company in subsequent fiscal years is as follows:

Year ending December 31:	
2011	\$1,188
2012	\$ 492
2013	\$ 349
2014	\$ 299
2015	\$ 205

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

NOTE 7. INCOME TAXES

Total income tax expense was allocated as follows:

	<u>Year Ended December 31,</u>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Income (loss) from operations	\$7,871	\$6,262	\$ (454)
Gain (loss) from discontinued operations	261	(173)	(250)
Deficiency (benefit) from stock plan transactions	(143)	127	(103)
Other comprehensive income (loss)	(778)	1,158	(10,198)
	<u>\$7,211</u>	<u>\$7,374</u>	<u>\$ (11,005)</u>

The components of the provision (benefit) for federal and state income taxes from operations were as follows:

	<u>Year Ended December 31,</u>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Currently payable (receivable)			
Federal	\$7,368	\$(2,997)	\$ 3,429
State	686	(103)	689
Total currently payable (receivable)	<u>8,054</u>	<u>(3,100)</u>	<u>4,118</u>
Deferred payable (prepaid)			
Federal	(984)	8,367	(3,692)
State	801	995	(880)
Total deferred payable (prepaid)	<u>(183)</u>	<u>9,362</u>	<u>(4,572)</u>
Provision (benefit) for income taxes	<u>\$7,871</u>	<u>\$ 6,262</u>	<u>\$ (454)</u>

The major items contributing to the difference between the statutory U.S. federal income tax rate and the Company's effective tax rate on income from continuing operations were as follows:

	<u>Year Ended December 31,</u>					
	<u>2010</u>		<u>2009</u>		<u>2008</u>	
Provision (benefit) at statutory rate	\$7,065	35.0%	\$5,801	35.0%	\$(538)	35.0%
State income taxes, net of federal tax benefit	989	4.9	752	4.5	(127)	8.3
Permanent differences, net	(2)	(0.0)	(35)	(0.2)	126	(8.2)
Stock based compensation	16	0.1	-	-	71	(4.7)
Other, net	(197)	(1.0)	(256)	(1.5)	14	(0.9)
Provision (benefit) for income taxes	<u>\$7,871</u>	<u>39.0%</u>	<u>\$6,262</u>	<u>37.8%</u>	<u>\$(454)</u>	<u>29.5%</u>

The tax effects of significant temporary differences that comprise deferred tax assets and liabilities are as follows:

	<u>December 31,</u>	
	<u>2010</u>	<u>2009</u>
Pension liability	\$14,027	\$13,208
Deferred gain on sale of building	1,545	1,854
Accrued expenses	3,596	3,684
Accrued vacation	1,174	1,386
Employee share-based compensation	521	630
Net operating loss carry forward, net of federal tax benefit	-	621
Receivables reserves	207	244
Other	330	257
Deferred tax assets	<u>\$21,400</u>	<u>\$21,884</u>

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

	December 31,	
	2010	2009
Unbilled receivables	\$ (4,106)	\$ (9,863)
Fixed assets and intangibles	(8,957)	(7,083)
Pension funding	(7,408)	(4,882)
Domestic International Sales Corporation	(2,198)	(2,183)
Other	(564)	(667)
Deferred tax liability	(23,233)	(24,678)
Deferred tax liability, net	\$ (1,833)	\$ (2,794)

Management believes that it is more likely than not that these deferred tax assets will be realized.

The Internal Revenue Service (“IRS”) had challenged the deferral of income for tax reporting purposes related to unbilled receivables including the applicability of a Letter Ruling issued by the IRS to the Company in January 1976 which granted to the Company deferred tax treatment of the unbilled receivables. This issue was elevated to the IRS National Office for determination. On October 23, 2008, the Company received a notification of ruling from the IRS National Office. This ruling provided clarification regarding the IRS position relating to revenue recognition for tax purposes regarding its unbilled receivables. During September 2009, the IRS completed its examination of the Company’s tax returns for 2004 through 2007 and issued a Revenue Agent Report (“RAR”), which reduced the deferral of income for tax reporting purposes. As a result the Company reclassified approximately \$1 million from deferred to current taxes payable. The RAR also included an assessment of interest of \$0.5 million. The Company has filed a protest letter with the IRS to appeal the assessment. The Company believes the appeal will be successful and has made no provision for the interest associated with the assessment.

As of December 31, 2009 the Company had a state net operating loss carry-forward of approximately \$11 million which was carried forward and fully utilized during 2010.

The change in the unrecognized tax benefits was as follows:

Balance at December 31, 2007	\$ 517
Reductions for current year tax positions	(87)
Balance at December 31, 2008	430
Additions for current year tax positions	132
Lapses of applicable statute of limitations	(153)
Balance at December 31, 2009	409
Reductions for current year tax positions	(31)
Balance at December 31, 2010	\$ 378

At December 31, 2010, the Company’s unrecognized tax benefits, which if recognized in future periods, could favorably impact the effective tax rate by approximately \$0.2 million. The total amount of accrued interest and penalties resulting from such unrecognized tax benefits was \$0.2 million at both December 31, 2010 and 2009.

The Company files income tax returns in the U.S. federal jurisdiction and numerous state jurisdictions. State tax returns for all years after 2006 are subject to future examination. Although the IRS has completed its examination of tax years 2004 through 2007 the statutes are still open for those years until the appeals process is finalized.

NOTE 8. FINANCING ARRANGEMENTS

The Company’s credit facility provides for a \$40.0 million, five-year term loan (the “term loan”) and a \$25.0 million, five-year revolving credit agreement for working capital (the “revolver”). The bank group, led by Brown Brothers Harriman & Co. as a lender and as administrative agent, also includes TD Bank, N.A. and Bank of America, N.A.

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

On an ongoing basis, the credit facility requires the Company to meet certain financial covenants, including maintaining a minimum net worth and certain cash flow and debt coverage ratios. The covenants also limit the Company's ability to incur additional debt, pay dividends, purchase capital assets, sell or dispose of assets, make additional acquisitions or investments, or enter into new leases, among other restrictions. In addition, the credit facility provides that the bank group may accelerate payment of all unpaid principal and all accrued and unpaid interest upon the occurrence and continuance of certain events of default, including, among others, the following:

- Any failure by the Company and its subsidiaries to make any payment of principal, interest and other sums due within three calendar days of the date when such payment is due;
- Any breach by the Company or any of its subsidiaries of certain covenants, representations and warranties;
- Any default and acceleration of any indebtedness owed by the Company or any of its subsidiaries to any person (other than the bank group) which is in excess of \$1.0 million;
- Any final judgment against the Company or any of its subsidiaries in excess of \$1.0 million which has not been insured to the reasonable satisfaction of Brown Brothers as administrative agent;
- Any bankruptcy (voluntary or involuntary) of the Company or any of its subsidiaries;
- Any material adverse change in the business or financial condition of the Company and its subsidiaries; or
- Any change in control of the Company.

At December 31, 2010, the Company was in compliance with its loan covenants.

The Company used the \$40.0 million term loan proceeds to fund the acquisition of Kadix. The credit facility requires quarterly principal payments on the term loan of \$2.0 million, which commenced December 31, 2008. The Company has the option of selecting an interest rate for the term loan equal to either: (a) the then applicable LIBOR rate plus 1.50% per annum to 2.50% per annum, depending on the Company's most recently reported leverage ratio (currently 1.50%); or (b) the base rate as announced from time to time by the administrative agent plus 0.00% per annum to 0.25% per annum, depending on the Company's most recently reported leverage ratio (currently 0.00%). For those portions of the term loan accruing at the LIBOR rate, the Company has the option of selecting interest periods of 30, 60, 90 or 180 days. The credit facility also required the Company, within thirty days of the closing date, to secure interest rate protection in an amount not less than fifty percent of the outstanding principal balance of the term loan, as more fully described in Note 10.

The revolver has a five-year term and is available to the Company for general corporate purposes, including strategic acquisitions. The interest rate terms on the revolver are similar to those of the term loan.

Outstanding Debt

The Company's outstanding debt at December 31, 2010 was \$22.0 million which consisted of an outstanding balance under the term loan. The interest rate on the term loan at December 31, 2010 was 1.79% based on the 90-day LIBOR rate option that was in effect on December 31, 2010. The Company's outstanding debt at December 31, 2009 was \$32.0 million which consisted of an outstanding balance of \$30.0 million under the term loan and \$2.0 million of net borrowings under the revolver. The interest rate on the term loan at December 31, 2009 was 2.28% based on the 90-day LIBOR rate option that was in effect on December 31, 2009. The interest rate on the revolver at December 31, 2009 was 3.25% based on the base rate that was in effect on December 31, 2009.

The repayment of borrowings under the revolver is contractually due on August 1, 2013 and therefore the amounts outstanding are classified as long-term, however, the Company may repay at any time prior to that date. At December 31, 2010, the remaining available balance to borrow against the revolver was \$24.6 million.

As noted above, the credit facility requires quarterly principal payments on the term loan of \$2.0 million, which commenced December 31, 2008. The Company's contractual obligations for principal payments on the term loan is \$8.0 million in each year ending December 31, 2011 through 2012 and \$6.0 million for the year ended December 31, 2013. However, the Company has the option to prepay principal at anytime during the term of the credit facility without penalty.

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

NOTE 9. FAIR VALUE MEASUREMENTS

The following tables present our assets and liabilities that are measured at fair value on a recurring basis:

	<u>Balance Sheet Classification</u>	Fair Value Measurements At December 31, 2010 Using			<u>Total</u>
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:					
Investments held in Rabbi Trusts	Other noncurrent assets	\$1,589	\$ -	\$ -	\$1,589
Liabilities:					
Interest rate swap	Other long-term liabilities	\$ -	\$ 467	\$ -	\$ 467

	<u>Balance Sheet Classification</u>	Fair Value Measurements At December 31, 2009 Using			<u>Total</u>
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:					
Investments held in Rabbi Trusts	Other noncurrent assets	\$1,378	\$ -	\$ -	\$1,378
Liabilities:					
Interest rate swap	Other long-term liabilities	\$ -	\$ 569	\$ -	\$ 569

The following is a description of the valuation methodologies used for these items, as well as the general classification of such items:

Investments held in Rabbi Trusts - The investments include exchange-traded equity securities and mutual funds. Fair values for these investments were based on quoted prices in active markets and were therefore classified within Level 1 of the fair value hierarchy.

Interest rate swap - The derivative is a receive-variable, pay-fixed interest rate swap based on the LIBOR rate and is designated as a fair value hedge. Fair value was based on a model-driven valuation using the LIBOR rate, which was observable at commonly quoted intervals for the full term of the swap. Therefore, our interest rate swap was classified within Level 2 of the fair value hierarchy.

NOTE 10. DERIVATIVE FINANCIAL INSTRUMENTS

The Company has an interest rate swap agreement with an initial notional amount of \$20.0 million of the term loan principal which matures on August 1, 2013. Under this agreement, the Company receives a floating rate based on the 90-day LIBOR rate and pays a fixed rate of 3.60% (both excluding the applicable margin) on the outstanding notional amount. The swap fixed rate was based on a 90-day LIBOR rate and is structured to mirror the payment terms of the term loan. The fair value of the swap at inception was zero. It is not expected that any gains or losses will be reported in the statement of operations during the term of the agreement as the swap is assumed to be highly effective through its maturity based on the matching terms of the swap and term loan.

As of December 31, 2010 and 2009, the total notional amount committed to the swap agreement was \$11.0 million and \$15.0 million, respectively. The Company recorded a liability to recognize the fair value of the swap which has been accounted for as a component of the accumulated other comprehensive loss.

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

The fair value effect on the financial statements from the interest rate swap designated as a cash flow hedge is as follows:

	<u>December 31,</u>		<u>Year Ended December 31,</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
Other long-term liabilities	\$ 467	\$ 569		
Loss recognized in other comprehensive income, net of tax			\$ 282	\$ 343

NOTE 11. EMPLOYEE BENEFIT PROGRAMS

Defined Benefit Pension Plan

The Company's Defined Benefit Pension Plan (the "Pension Plan") is non-contributory, covering substantially all employees of the Company who had completed a year of service prior to July 1, 2002. Membership in the Pension Plan was frozen effective July 1, 2002 and participants' calculated pension benefit was frozen effective December 31, 2006.

The Company's funding policy is to contribute at least the minimum amount required by the Employee Retirement Income Security Act of 1974. Additional amounts are contributed to assure that plan assets will be adequate to provide retirement benefits. The Company expects required payments of \$4.0 million will be needed to fund the Pension Plan in 2011.

The Company's Pension Plan measurement date was changed to December 31 from November 30 in 2008.

Net Periodic Pension Cost

	<u>Year Ended December 31,</u>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Interest cost	\$ 4,217	\$ 4,269	\$ 4,103
Expected return on plan assets	(4,516)	(3,857)	(5,975)
Recognized actuarial loss	1,098	1,209	586
Net periodic pension cost (income)	<u>\$ 799</u>	<u>\$ 1,621</u>	<u>\$(1,286)</u>

Obligations and Funded Status

	<u>December 31,</u>	
	<u>2010</u>	<u>2009</u>
<i>Change in benefit obligation</i>		
Benefit obligation at beginning of year	\$ 75,233	\$ 69,691
Interest cost	4,217	4,269
Benefits paid	(3,683)	(3,450)
Actuarial loss	4,655	4,723
Benefit obligation at end of year	<u>80,422</u>	<u>75,233</u>
<i>Change in plan assets</i>		
Fair value of plan assets at beginning of year	53,727	47,121
Actual return on plan assets	6,006	10,001
Employer contributions	3,678	55
Benefits paid	(3,683)	(3,450)
Fair value of plan assets at end of year	<u>59,728</u>	<u>53,727</u>
<i>Funded status</i>	<u><u>\$(20,694)</u></u>	<u><u>\$(21,506)</u></u>

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

Amounts recognized in the consolidated balance sheets consist of:

	<u>December 31,</u>	
	<u>2010</u>	<u>2009</u>
Accrued compensation and employee benefits	\$ 4,000	\$ 840
Other long-term liabilities	16,694	20,666
Net amount recognized	<u>\$20,694</u>	<u>\$21,506</u>

At December, 31, 2010, the Company increased its pension liability adjustment by \$2.1 million to reflect the required liability of \$35.4 million. In 2009, the Company decreased its pension liability adjustment by \$2.6 million to reflect the required liability of \$33.3 million. These amounts are reflected, net of related tax effects, as a component of accumulated other comprehensive loss as part of stockholders' equity in the accompanying balance sheets.

The reconciliation of the pension liability adjustment was as follows:

	<u>Beginning</u>	<u>Amortization</u>	<u>Experience</u>	<u>Ending</u>
	<u>Balance</u>		<u>Loss/ (Gain)</u>	
2010	\$ 33,312	\$ (1,098)	\$ 3,165	\$35,379
2009	\$ 35,942	\$ (1,209)	\$ (1,421)	\$33,312
2008	\$ 11,260	\$ (635)	\$ 25,317	\$35,942

The Company expects to recognize amortization expense related to the net actuarial loss of approximately \$1.2 million in 2011.

Assumptions

The assumed discount rate, which is intended to be the actual rate at which benefits could effectively be settled, is determined by a spot-rate yield curve method. The spot-rate yield curve is employed to match the plan assets cash outflows with the timing and amount of the expected benefit payments.

The assumed long-term rate of return on plan assets, which is the average return expected on the funds invested or to be invested to provide future benefits to pension plan participants, is determined by an annual review of historical plan assets returns and consultation with outside investment advisors. In selecting the expected long-term rate of return on assets, the Company considered its investment return goals stated in the Pension Plan's investment policy. The Company, with input from the Pension Plan's professional investment managers, also considered the average rate of earnings expected on the funds invested or to be invested to provide Pension Plan benefits. This process included determining expected returns for the various asset classes that comprise the Pension Plan's target asset allocation.

The following assumptions were used to determine the benefit obligations and net periodic benefit costs:

	<u>December 31,</u>		
	<u>2010</u>	<u>2009</u>	
<i>Used to determine benefit obligations</i>			
Discount rate	5.25%	5.75%	
Rate of compensation increase	N/A	N/A	
<i>Used to determine net periodic benefit costs</i>			
Discount rate	5.75%	6.25%	6.25%
Expected rate of return on assets	8.50%	8.50%	9.00%
Rate of compensation increase	N/A	N/A	N/A

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

Plan Assets

The Company's overall investment strategy for plan assets is to achieve a long-term rate of return of 8.5%, with a wide diversification of asset types, fund strategies and fund managers. The target allocation for the plan assets are 55% in equity securities, 38% in fixed income securities, 5% in other types of investments and 2% in cash and cash equivalents. The risk management practices include regular evaluations of fund managers to ensure the risk assumed is commensurate with the given investment style and objectives. Prohibited investments include, but are not limited to private placements, limited partnerships, venture-capital investments, real estate properties and collateralized mortgage obligation.

The Company's investment policy includes a periodic review of the Pension Plan's investment in the various asset classes. The Company's asset allocations by asset category are as follows:

Asset Category	Total	Fair Value Measurement at December 31, 2010		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash	\$ 414	\$ 414	\$ -	\$ -
Money market funds	4,227	-	4,227	-
Equity securities:				
Common equity securities	11,183	7,505	3,678	-
Preferred equity securities	142	142	-	-
Equity mutual funds	21,593	21,593	-	-
Fixed income securities:				
U.S. Treasury obligations	7,046	-	7,046	-
U.S. Government agencies	1,278	-	1,278	-
Corporate and foreign bonds	9,626	-	9,626	-
Other type of investments:				
Managed futures	2,024	-	-	2,024
Hedge fund	2,195	-	-	2,195
Total	<u>\$59,728</u>	<u>\$29,654</u>	<u>\$ 25,855</u>	<u>\$ 4,219</u>

The Pension Plan's assets did not include any of the Company's common stock at December 31, 2010 and 2009.

A reconciliation of the beginning and ending balances of Level 3 assets is as follows:

	Fair Value Measurement Using Significant Unobservable Inputs (Level 3)		
	Managed Futures	Hedge Fund	Total
Beginning balance at December 31, 2009	\$ 2,000	\$1,000	\$3,000
Unrealized gains on plan assets:			
Relating to assets still held at the reporting date		24	195
Relating to assets sold during the period		-	-
Purchases		-	1,000
Transfers in and/or out of Level 3		-	-
Ending balance at December 31, 2010	<u>\$ 2,024</u>	<u>\$2,195</u>	<u>\$4,219</u>

The managed futures consist of units of limited partnership interests through the allocation of assets of multiple commodity trading advisors. These commodity trading advisors engage in speculative trading in U.S. and international markets for currencies, interest rates, stock indices, agricultural and energy products, and precious base

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

metals. The fair value of managed futures is estimated based on the investments net asset value at the reporting period. Redemptions can only be made monthly and require ten days prior notice to the general partner of the fund.

The hedge fund is a fund of funds that combines diversified multi-strategy methods to achieve investment objectives during a three to five year investment cycle. Strategy methods may consist of conventional long-term equity and fixed income investments or derivative investments, including, total return swaps, options and forwards. The fair value of the hedge fund is estimated based on the investments net asset value at the reporting period. Redemptions can be made quarterly based on the discretion of the investment company's board of directors.

Estimated Future Benefit Payments

The following table sets forth the expected timing of benefit payments:

Year ending December 31:	
2011	\$ 3,915
2012	\$ 4,188
2013	\$ 4,458
2014	\$ 4,605
2015	\$ 4,821
Five subsequent fiscal years ending December 31, 2020	\$26,314

401(k) Plan

The Company maintains a cash or deferred savings plan, the 401(k) Plan. All employees are eligible to elect to defer a portion of their salary and contribute the deferred portion to the 401(k) Plan.

The 401(k) Plan is structured with two components: (i) a Company matching contribution for 100% of the first 2% of the employee contribution and an additional 50% of the next 4% of the employee contribution; and (ii) a discretionary profit sharing contribution by the Company for all eligible employees.

Employee contributions and the Company's contributions are invested in one or more collective investment funds at the participant's direction. The Company's contributions are subject to forfeitures of any non-vested portion if termination occurs. The vesting of the Company's matching contribution is 25% after one year and 100% after the second year. The vesting of profit sharing contributions is 100% cliff vesting after three years. The Company's contributions, net of forfeitures, charged to expense aggregated \$3.3 million, \$3.5 million and \$3.1 million in 2010, 2009 and 2008, respectively.

Supplemental Executive Retirement Plan

The Company has a Supplemental Executive Retirement Plan, or SERP, for certain former key employees providing for annual benefits commencing on the sixth anniversary of the executive's retirement. The cost of these benefits is being charged to expense and accrued using a projected unit credit method. Expenses related to this plan were approximately \$0.1 million in each of the years ended December 31, 2010. The liability related to the SERP, which is unfunded, was \$0.4 million at both December 31, 2010 and 2009. These amounts represent the amounts the Company estimates to be the present value of the obligation at each respective date.

Deferred Compensation Plans

The Company has a deferred compensation plan approved by the Board of Directors that allows certain employees to defer up to 100% of cash incentive payments and salary in excess of the FICA earnings ceiling. Employee contributions are invested in selected mutual funds held within a Rabbi Trust. These investments, which the Company has classified as trading securities, are recorded at fair value and reported as a component of other noncurrent assets in the accompanying balance sheets. Amounts recorded as deferred compensation liabilities are adjusted to reflect the fair value of investments held by the Rabbi Trust. Changes in obligations to participants as a

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

result of gains or losses on the fair value of the investments are reflected as a component of compensation expense. At December 31, 2010 and 2009, \$1.6 million and \$1.4 million, respectively, had been deferred under the plan.

The Company also has a deferred compensation plan under which non-employee directors may elect to defer their directors' fees. Amounts deferred for each participant are credited to a separate account, and interest at the lowest rate at which the Company borrowed money during each quarter is credited quarterly. The balance in a participant's account is payable in a lump sum or in installments when the participant ceases to be a director.

NOTE 12. SHARE-BASED COMPENSATION

Share-Based Compensation Plans

The Company has four shareholder approved equity incentive plans, which are administered by the Compensation Committee of the Board of Directors (the "Committee"). The Committee determines which employees receive grants, the number of shares or options granted and the exercise prices of the shares covered by each grant.

The Company's 1993 Equity Incentive Plan (the "1993 Plan") expired in April 2003. The 1993 Plan permitted the Company to grant incentive stock options, nonqualified stock options, stock appreciation rights, awards of nontransferable shares of restricted common stock and deferred grants of common stock. The option price of incentive stock options was not less than the fair market value at the time the option was granted. The option period was not greater than 10 years from the date the option was granted. Normally the stock options were exercisable in three equal installments beginning one year from the date of the grant. Through shareholder approval, 580,800 shares were reserved for the 1993 Plan. A total of 9,500, 10,000 and 12,000 stock options were outstanding and exercisable under the 1993 Plan at December 31, 2010, 2009 and 2008, respectively.

The Company's 1995 Stock Option Plan for Non-employee Directors (the "1995 Plan") expired in April 2006. The 1995 Plan provided for each outside director to receive options to purchase 5,000 shares of common stock at the first annual meeting at which the director was elected. As long as he or she remained an eligible director, the director received options to purchase 1,000 shares of common stock at each annual meeting. Eligible directors could not be an employee of the Company or one of its subsidiaries or a holder of five percent or more of the Company's common stock. The exercise price of these options was the fair market value of the common stock on the date of grant. Each option was non-transferable except upon death and expires 10 years after the date of grant. The options became exercisable in three equal installments on the first, second and third anniversaries of the date of grant. A total of 132,000 shares were reserved for issuance. A total of 10,000, 11,000 and 12,214 stock options were outstanding and exercisable under the 1995 Plan at December 31, 2010, 2009 and 2008, respectively.

The Company's 2000 Incentive Plan (the "2000 Plan") expired in November 2009. The 2000 Plan allowed the Company to grant incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock awards and deferred grants of common stock. In the case of incentive stock options, the option price was not less than the fair market value of the stock at the date of grant. The option period did not exceed 10 years from the date of grant. The terms of the 2000 Plan were substantially similar to those of the 1993 Plan. A total of 412,990, 585,843 and 664,894 stock options were outstanding and exercisable under the 2000 Plan at December 31, 2010, 2009 and 2008, respectively.

The Company's 2003 Incentive Plan (the "2003 Plan") allows the Company to grant incentive stock options, non-qualified stock options, stock appreciation rights, awards of nontransferable shares of restricted common stock and deferred grants of common stock up to directors or key employees of the Company. The terms of the 2003 Plan are substantially similar to those of the 2000 Plan. A total of 400,000 shares were reserved for issuance of which 309,124 shares remained available at December 31, 2010. A total of 40,000 stock options were outstanding and non-exercisable under the 2003 Plan at December 31, 2010. The 2003 Plan expires in December 2012.

Restricted stock awards granted by the Company were issued under the 2000 Plan and 2003 Plan. Shares of restricted stock of the Company may be granted at no cost to employees. Restrictions limit the sale or transfer of these shares until they vest, which is typically over three years. The Company granted a total of 30,300 restricted stock awards from the 2003 Plan during the year ended December 31, 2010. During 2009, the Company granted a total of 100,748 restricted

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

stock awards of which 66,750 and 33,998 restricted stock awards were granted from the 2000 Plan and the 2003 Plan, respectively. During 2008, the Company granted 92,000 restricted stock awards from the 2000 Plan. Restricted stock awards of 56,404, 137,725 and 158,476 were unvested and outstanding under the 2000 Plan as of December 31, 2010, 2009 and 2008, respectively, and 42,351 and 27,976 awards were unvested and outstanding under the 2003 Plan as of December 31, 2010 and 2009, respectively.

The Company's Executive Long Term Incentive Program (the "ELTIP") provides incentives to program participants through a combination of cash incentives, stock options and restricted stock grants. Included in the 2000 Plan amounts stated above, the Board of Director approved 2001 ELTIP, which fully vested in May 2008, had a total of 375,000, 425,000 and 475,000 stock options that were outstanding and exercisable at December 31, 2010, 2009 and 2008, respectively.

During 2010, the Company's shareholders approved the 2010 ELTIP which is administered by the Compensation Committee of the Company. The Company recorded compensation costs for all share-based compensation that is expected to be issued based on the achievement of certain goals. Additional information regarding the 2010 ELTIP is included in the Company proxy statement under the heading Approval of Executive Long-Term Incentive Plan, filed with the Securities Exchange Commission on Form DEF14 A on April 15, 2010.

Employee Stock Purchase Plan

The Company's shareholders approved the 2000 Employee Stock Purchase Plan (the "ESPP") which is designed to give eligible employees an opportunity to purchase common stock of the Company through accumulated payroll deductions. All employees of the Company who customarily work at least 20 hours per week and do not own five percent or more of the Company's common stock are eligible to participate in the ESPP. The ESPP allows stock to be purchased at a discount of 5% and does not include a "look-back" option, therefore the accounting for shares purchased is not considered compensatory. A total of 1,300,000 shares are available for issuance under the ESPP, of which 364,336 shares were remaining at December 31, 2010. Shares issued under the ESPP were 34,266 in 2010, 38,953 in 2009 and 46,880 in 2008.

Share-Based Compensation Costs

Total share-based compensation cost reported in the consolidated statements of operations was as follows:

	<u>Year Ended December 31,</u>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Cost of products and services	\$ 324	\$ 319	\$ 483
Selling, general and administrative	394	417	665
Total share-based compensation expense	<u>\$ 718</u>	<u>\$ 736</u>	<u>\$1,148</u>

Stock Option Award Activity

The following table summarizes stock option activity under all plans:

	<u>Number of Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Term (in years)</u>	<u>Aggregate Intrinsic Value</u>
Outstanding and exercisable at December 31, 2009	606,843	\$ 9.62	1.5	\$ 981
Granted	40,000	\$ 13.36		
Exercised	(161,484)	\$ 8.52		
Cancelled	(12,869)	\$ 12.76		
Outstanding at December 31, 2010	<u>472,490</u>	\$ 10.23	1.5	\$ 1,688
Exercisable at December 31, 2010	<u>432,490</u>	\$ 9.94	0.7	\$ 1,684

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

As of December 31, 2010 the total unrecognized compensation cost related to stock option awards was \$0.2 million which is expected to be amortized over approximately 2.5 years.

The fair value of share-based awards for employee stock option awards was estimated using the Black-Scholes pricing model. The following weighted average assumptions were used to calculate the weighted per share fair value of \$6.43 for stock options issued during 2010: risk-free rate of 2.4%; dividend yield of zero; volatility of 47.7%; and expected life of 6 years.

The Company selected the assumptions used in the Black-Scholes pricing model using the following criteria:

Risk-free interest rate. The Company bases the risk-free interest rate on implied yields available on a U.S. Treasury note with a maturity term equal to or approximating the expected term of the underlying award.

Dividend yield. The Company does not intend to pay dividends on its common stock for the foreseeable future and, accordingly, uses a dividend yield of zero.

Volatility. The expected volatility of the Company's shares was estimated based upon the historical volatility of the Company's share price with consideration given to the expected life of the award.

Expected life. The expected term was estimated based upon exercise experience made in the past to employees.

Cash proceeds received, the intrinsic value and the total tax benefits realized resulting from stock option exercises were as follows:

	<u>Year Ended December 31,</u>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Amounts realized or received from stock option exercises:			
Cash proceeds received	\$1,108	\$ 631	\$ 449
Intrinsic value realized	\$ 598	\$1,972	\$ 267
Income tax benefit realized	\$ 166	\$ 84	\$ 101

Restricted Stock Award Activity

The following table summarizes restricted stock activity:

	<u>Number of Shares</u>	<u>Weighted Average Grant- Date Fair Value</u>
Nonvested at December 31, 2009	165,701	\$ 9.39
Granted	30,300	\$ 10.99
Vested	(73,711)	\$ 9.77
Cancelled	(23,535)	\$ 9.48
Nonvested at December 31, 2010	<u>98,755</u>	<u>\$ 9.57</u>

The total fair value of restricted shares vested during 2010, 2009 and 2008 was \$0.7 million, \$0.8 million and \$1.6 million, respectively. As of December 31, 2010, the total unrecognized compensation cost related to restricted stock awards was \$0.6 million which is expected to be amortized over a weighted-average period of approximately 1.8 years.

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

NOTE 13. SHAREHOLDERS' EQUITY

Preferred Stock Purchase Rights

On June 5, 2008, the Board of Directors of the Company approved a shareholder Rights Agreement, subject to finalization of price, which was approved by the Board on July 23, 2008 at \$59.09 per one one-hundredth of a Preferred Share.

On July 23, 2008, the Board of Directors of the Company authorized and declared a dividend distribution of one right (a "Right") for each outstanding share of the Company's common stock, par value \$0.10 per share to stockholders of record at the close of business on such date. Each Right entitles the registered holder to purchase from the Company one one-hundredth of a share of Series B Preferred Stock, par value \$0.10 per share, of the Company (the "Preferred Stock"), at a price of \$59.09 per one one-hundredth of a Preferred Share, subject to adjustment. The definitive terms of the Rights are set forth in a Rights Agreement, dated as of July 23, 2008, between the Company and American Stock Transfer & Trust Company, LLC, as Rights Agent.

The Rights become exercisable upon the earlier of the following events: (i) 10 days following a public announcement that a person or group of affiliated or associated persons have acquired beneficial ownership of 15% or more of the outstanding Common Stock or (ii) 10 business days (or such later date as may be determined by action of the Board of Directors prior to such time as any person or group of affiliated or associated persons becomes an acquiring person) following the commencement of, or announcement of an intention to make, a tender offer or exchange offer the consummation of which would result in the beneficial ownership by a person or group of 15% or more of the outstanding Common Stock (the earlier of such dates being the distribution date). The Rights will expire on July 27, 2018.

Share Repurchase Program

In December 2010, The Company's board of directors authorized a share repurchase program, which allows the Company to buy back up to 700,000 shares of its common stock through June 6, 2011. During 2010, the Company repurchased 40,400 shares at a weighted average price of \$13.60. The timing, price and amount of any repurchase will be determined by management based on its evaluation of market conditions and other factors. These repurchases may be made through the open market, including block purchases, or in private negotiated transactions, or otherwise. The buyback will be funded through available cash balances and or borrowings, and may be suspended or discontinued at any time. At December 31, 2010, there were 659,600 shares available to be repurchased under the program.

Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss as of December 31, 2010 of \$21.7 million consisted of aggregate additional pension liability adjustments of \$21.4 million, net of a \$14.0 million tax benefit and an unrealized holding loss on a derivative instrument of \$0.3 million, net of a tax benefit of \$0.2 million. Accumulated other comprehensive loss as of December 31, 2009 of \$20.5 million consisted of aggregate additional pension liability adjustments of \$20.2 million, net of a \$13.2 million tax benefit and an unrealized holding loss on a derivative instrument of \$0.3 million, net of a tax benefit of \$0.2 million.

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

The related tax effects allocated to each component of other comprehensive income (loss) was as follows:

	<u>Before Tax Amount</u>	<u>Tax (Expense) Benefit</u>	<u>Net of Tax Amount</u>
Year ended December 31, 2008			
Pension liability adjustment	\$(25,268)	\$ 10,018	\$(15,250)
Less: reclassification adjustment for costs realized in net loss	586	(232)	354
Net pension liability adjustment	<u>(24,682)</u>	<u>9,786</u>	<u>(14,896)</u>
Unrealized holding losses on derivative instruments	(860)	341	(519)
Reclassification adjustment for gains on investments realized in net loss	(179)	71	(108)
Other comprehensive loss	<u><u>\$(25,721)</u></u>	<u><u>\$ 10,198</u></u>	<u><u>\$(15,523)</u></u>
Year ended December 31, 2009			
Pension liability adjustment	\$ 1,421	\$ (564)	\$ 857
Less: reclassification adjustment for costs realized in net income	1,209	(479)	730
Net pension liability adjustment	<u>2,630</u>	<u>(1,043)</u>	<u>1,587</u>
Unrealized holding losses on derivative instruments	(175)	69	(106)
Less: reclassification adjustment for costs realized in net income	466	(184)	282
Net unrealized holding gain on derivative instruments	<u>291</u>	<u>(115)</u>	<u>176</u>
Other comprehensive income	<u><u>\$ 2,921</u></u>	<u><u>\$ (1,158)</u></u>	<u><u>\$ 1,763</u></u>
Year ended December 31, 2010			
Pension liability adjustment	\$ (3,164)	\$ 1,254	\$ (1,910)
Less: reclassification adjustment for costs realized in net income	1,098	(435)	663
Net pension liability adjustment	<u>(2,066)</u>	<u>819</u>	<u>(1,247)</u>
Unrealized holding losses on derivative instruments	(344)	136	(208)
Less: reclassification adjustment for costs realized in net income	446	(177)	269
Net unrealized holding gain on derivative instruments	<u>102</u>	<u>(41)</u>	<u>61</u>
Other comprehensive loss	<u><u>\$ (1,964)</u></u>	<u><u>\$ 778</u></u>	<u><u>\$ (1,186)</u></u>

Earnings Per Share

Due to their antidilutive effect, approximately 98,500, 63,000 and 279,200 options to purchase common stock were excluded from the calculation of diluted earnings per share for the years ended December 31, 2010, 2009 and 2008, respectively. However, these options could become dilutive in future periods. The following table sets forth the reconciliation of the weighted average shares outstanding:

	<u>Year Ended December 31,</u>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Weighted average shares outstanding - Basic	9,893,322	9,551,614	9,493,495
Dilutive effect of stock options and restricted stock grants	185,615	221,108	-
Weighted average shares outstanding - Diluted	<u><u>10,078,937</u></u>	<u><u>9,772,722</u></u>	<u><u>9,493,495</u></u>

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

NOTE 14. BUSINESS SEGMENT, GEOGRAPHIC, MAJOR CUSTOMER AND RELATED PARTY INFORMATION

Business Segment

The Company operates in one business segment providing support to its customers in the primary mission areas of information technology, logistics and readiness, information assurance and cyber security, homeland security, healthcare and intelligence and space. The Company offers several business solutions to its customers, often combining two or more solutions to achieve customer goals, including business transformation, information technology infrastructure, training and performance support, business intelligence, automated case management, program management, engineering, human capital management, information assurance and cyber security and healthcare.

Geographic

Revenue is attributed to geographic areas based on the customer's location. The Company does not have locations outside the U.S. and substantially all revenue was earned in the U.S during each of the three years ended December 31, 2010. The Company's long-lived assets of \$116.2 million and \$119.0 million at December 31, 2010 and 2009, respectively, were located in the U.S. Long-lived assets included property and equipment, goodwill, intangible assets and other noncurrent assets.

Major Customers

No customers accounted for more than 10% of revenue in each of the three years ended December 31, 2010 and no customers accounted for more than 10% of the contract receivable balance at December 31, 2010 and 2009.

Related Party

The Company has a 40% interest in HMRTech which is accounted for using the equity method. Revenues from HMRTech for 2010 and 2009 and amounts due from HMRTech included in contract receivables at December 31, 2010 and 2009 were immaterial. Revenues recorded from HMRTech in 2008 were \$4.8 million. In addition, HMRTech charged the Company \$1.9 million, \$1.3 million and \$1.4 million in 2010, 2009 and 2008, respectively, relating to contract work. At December 31, 2010 and 2009, the Company had a related payable of \$0.3 million and \$0.2 million, respectively.

NOTE 15. COMMITMENTS AND CONTINGENCIES

Commitments

The Company conducts its operations in facilities that are under long-term operating leases. These leases expire at various dates through 2018, with options to renew as negotiated between the Company and its landlords. With the exception of the Company's current corporate headquarters facility, the Company does not believe that exercise of any of its lease renewal options are reasonably assured and, accordingly, the exercise of such options has not been assumed in the accounting for leasehold improvements and the deferred gain on the sale of the former corporate headquarters facility. Rent expense under these leases, inclusive of real estate taxes and insurance, was \$5.3 million in 2010, \$5.9 million in 2009 and \$5.8 million in 2008.

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

Minimum lease commitments, primarily for facilities under non-cancelable operating leases and related sublease receipts in effect at December 31, 2010 were as follows:

	<u>Lease Commitment</u>	<u>Sublease Receipts</u>
Year ending December 31:		
2011	\$ 6,645	\$ 2,313
2012	6,463	1,732
2013	6,215	1,732
2014	6,094	1,732
2015	5,615	1,732
2016 and thereafter	7,046	-
	<u>\$ 38,078</u>	<u>\$ 9,241</u>

The Company entered into letter of credit agreements with its bank group for a total of \$0.6 million to satisfy required lease security deposits.

During 2009, the Company entered into an assignment and assumption agreement to assign all of the Company's right, title, and interest in, to and under its former corporate headquarters facility. The effective date of the agreement was December 1, 2009, the date the Company vacated the building. The terms of the agreement assign the sublessee all of the rights and obligations of the original lease signed by the Company in 2005. The original lease includes two consecutive five year renewal options. If these options are exercised by the sublessee, the Company will be released for the option periods by the landlord. The Company is continuing to amortize the deferred gain over the original ten year lease period. The agreement also provides the sublessee the use of certain Company owned furniture in connection with their occupancy of the building.

Contingencies

As a defense contractor, the Company is subject to many levels of audit and review from various government agencies, including the Defense Contract Audit Agency, various inspectors general, the Defense Criminal Investigation Service, the Government Accountability Office, the Department of Justice and Congressional committees. Both related to and unrelated to its defense industry involvement, the Company is, from time to time, involved in audits, lawsuits, claims, administrative proceedings and investigations. The Company accrues for liabilities associated with these activities when it becomes probable that future expenditures will be made and such expenditures can be reasonably estimated. Except as noted below, the Company does not presently believe it is reasonably likely that any of these matters would have a material adverse effect on the Company's business, financial position, results of operations or cash flows. The Company's evaluation of the likelihood of expenditures related to these matters is subject to change in future periods, depending on then current events and circumstances, which could have material adverse effects on the Company's business, financial position, results of operations and cash flows.

On June 28, 2005, a class action employee suit was filed in the U.S. District Court for the District of Massachusetts alleging violations of the Fair Labor Standards Act and certain provisions of Massachusetts General Laws. In July 2010, the Company and the plaintiff agreed upon principle terms of settlement, the cost of which was accrued on the balance sheet as of June 30, 2010. In October 2010, the Company received an executed settlement agreement by the plaintiff. The Federal District Court for the First Circuit has reviewed the settlement and the parties are expecting the court's approval in the first quarter of 2011.

In August 2009, the Company, the Department of Justice and the United States Attorney Office, Boston, MA, executed a settlement agreement involving the Company's admission of liability solely for breach of contract, payment of \$15.0 million to the government, of which \$14.8 million was included in selling, general and administrative expenses in 2008, and dismissal with prejudice of all other claims against the Company.

DYNAMICS RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(dollars in thousands, except per share amounts)

NOTE 16. QUARTERLY RESULTS (UNAUDITED)

During the fourth quarter of 2009, the Company entered into a plan to sell the Metrigraphics business segment. The results listed below were restated to reflect Metrigraphics as a discontinued operation for all periods presented. Refer to Note 3 for additional information regarding Metrigraphics.

	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>	<u>Fiscal Year</u>
2010					
Revenue	\$68,584	\$65,308	\$68,420	\$69,753	\$272,065
Gross profit	\$10,757	\$10,197	\$10,790	\$12,146	\$ 43,890
Operating income	\$ 4,416	\$ 4,731	\$ 5,208	\$ 6,460	\$ 20,815
Income from continuing operations	\$ 2,737	\$ 2,579	\$ 3,006	\$ 3,991	\$ 12,313
Income from discontinued operations	132	173	87	-	392
Net income	<u>\$ 2,869</u>	<u>\$ 2,752</u>	<u>\$ 3,093</u>	<u>\$ 3,991</u>	<u>\$ 12,705</u>
Earnings per share: ⁽¹⁾					
Basic					
Income from continuing operations	\$ 0.28	\$ 0.26	\$ 0.30	\$ 0.40	\$ 1.24
Income from discontinued operations	0.01	0.02	0.01	-	0.04
Net income	<u>\$ 0.29</u>	<u>\$ 0.28</u>	<u>\$ 0.31</u>	<u>\$ 0.40</u>	<u>\$ 1.28</u>
Diluted					
Income from continuing operations	\$ 0.27	\$ 0.26	\$ 0.30	\$ 0.39	\$ 1.22
Income from discontinued operations	0.01	0.02	0.01	-	0.04
Net income	<u>\$ 0.29</u>	<u>\$ 0.27</u>	<u>\$ 0.31</u>	<u>\$ 0.39</u>	<u>\$ 1.26</u>
2009					
Revenue	\$67,203	\$68,128	\$67,504	\$65,826	\$268,661
Gross profit	\$11,260	\$11,113	\$10,622	\$11,972	\$ 44,967
Operating income	\$ 3,976	\$ 3,930	\$ 4,058	\$ 5,944	\$ 17,908
Income from continuing operations	\$ 1,957	\$ 2,174	\$ 2,896	\$ 3,286	\$ 10,313
Income (loss) from discontinued operations	(186)	(124)	59	110	(141)
Net income	<u>\$ 1,771</u>	<u>\$ 2,050</u>	<u>\$ 2,955</u>	<u>\$ 3,396</u>	<u>\$ 10,172</u>
Earnings per share: ⁽¹⁾					
Basic					
Income from continuing operations	\$ 0.20	\$ 0.23	\$ 0.30	\$ 0.34	\$ 1.08
Income (loss) from discontinued operations	(0.02)	(0.02)	0.01	0.01	(0.02)
Net income	<u>\$ 0.18</u>	<u>\$ 0.21</u>	<u>\$ 0.31</u>	<u>\$ 0.35</u>	<u>\$ 1.06</u>
Diluted					
Income from continuing operations	\$ 0.20	\$ 0.22	\$ 0.29	\$ 0.33	\$ 1.06
Income (loss) from discontinued operations	(0.02)	(0.01)	0.01	0.01	(0.02)
Net income	<u>\$ 0.18</u>	<u>\$ 0.21</u>	<u>\$ 0.30</u>	<u>\$ 0.34</u>	<u>\$ 1.04</u>

(1) Basic and diluted earnings per share is computed independently for each of the quarters presented; accordingly, the sum of the quarterly earnings per share may not equal the total computed for the year. The components of basic and diluted earnings per share are also computed independently for each quarter presented; accordingly amounts may not add due to rounding.

DYNAMICS RESEARCH CORPORATION
SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS AND RESERVES

	<u>Additions</u>				<u>Balance at End of Period</u>
	<u>Balance at Beginning of Period</u>	<u>Charged to Costs and Expenses</u>	<u>Charged to Other Accounts</u>	<u>s Deduction and Write-Offs</u>	
Allowance for doubtful accounts					
Year ended December 31,					
2010	\$ 583	\$ 388	\$ -	\$ (450)	\$ 521
2009	\$ 910	\$ 124	\$ -	\$ (451)	\$ 583
2008	\$ 873	\$ 249	\$ -	\$ (212)	\$ 910

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The Company's principal executive officer ("CEO") and principal financial officer ("CFO") evaluated, together with other members of senior management, the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of December 31, 2010; and, based on this review, the Company's CEO and CFO concluded that, as of December 31, 2010, the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed by it in the reports that it files or submits under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (ii) is accumulated and communicated to the Company's management, including the Company's CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

Management Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Our management conducted an assessment of the effectiveness of our internal control over financial reporting. This assessment was based upon the criteria for effective internal control over financial reporting established in *Internal Control — Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission.

The Company's internal control over financial reporting involves a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes the controls themselves, as well as monitoring of the controls and internal auditing practices and actions to correct deficiencies identified. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements.

A material weakness is a deficiency (within the meaning of Public Company Accounting Oversight Board Auditing Standard No. 5), or combination of deficiencies in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2010. Based on this assessment, management concluded that, as of December 31, 2010, the Company's internal control over financial reporting was effective.

Attestation Report of Registered Public Accounting Firm

The Company's internal control over financial reporting as of December 31, 2010 has been audited by Grant Thornton LLP, an independent registered public accounting firm, as stated in their report, which is included herein.

Changes in Internal Control over Financial Reporting

There has been no change in the Company's internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) during the quarterly period ended December 31, 2010 that has materially affected, or is reasonably likely to materially effect, the Company's internal control over financial reporting.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and
Shareholders of Dynamics Research Corporation:

We have audited Dynamics Research Corporation's internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Dynamics Research Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on Dynamics Research Corporation's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Dynamics Research Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control—Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Dynamics Research Corporation as of December 31, 2010 and 2009, and the related consolidated statements of operations, changes in stockholders' equity and comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2010 and our report dated February 28, 2011 expressed an unqualified opinion.

/s/ Grant Thornton LLP

Boston, Massachusetts
February 28, 2011

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Information required by this item is hereby incorporated by reference to the Company's definitive proxy statement under the captions "Election of Directors," "Report of the Audit Committee of the Board of Directors," "Other Directors and Officer Information" and "Executive Compensation" to be filed by the Company within 120 days after the close of its fiscal year.

Executive Officers of the Registrant

The following is a list of the names and ages of our executive officers, all positions and offices held by each person and each person's principal occupations or employment during the past five years. The officers were elected by the Board of Directors and will hold office until the next annual election of officers and their successors are elected and qualified, or until their earlier resignation or removal by the Board of Directors. There are no family relationships between any executive officers and directors.

<u>Name</u>	<u>Executive Office Held</u>	<u>Age</u>
James P. Regan	President, Chairman and Chief Executive Officer	70
Richard A. Covell	Vice President, General Counsel and Secretary	64
David Keleher	Senior Vice President and Chief Financial Officer	61
Steven P. Wentzell	Senior Vice President and General Manager, Human Resources	64
Lawrence H. O'Brien, Jr.	Senior Vice President and General Manager, Business Solutions and Business Development	59

Mr. Regan joined us in 1999 as President, Chief Executive Officer and Director and was elected Chairman in April 2001. Prior to joining us, he was President and Chief Executive Officer of CVSI, Inc. from 1997 to October 1999. Prior to that, he served as Senior Vice President of Litton PRC from 1992 to 1996.

Mr. Covell joined us as Vice President and General Counsel in December 2000. Prior to joining us, he was General Counsel, Patent Counsel and Secretary at Foster-Miller, Inc. from 1985 to 2000.

Mr. Keleher joined us as Vice President and Chief Financial Officer in January 2000. Prior to joining us, he was employed by Raytheon Company as Group Controller for the Commercial Electronics Division in 1999 and Assistant Corporate Controller in 1998. Prior to that, he served in several senior management positions in corporate finance and operations at Digital Equipment Corporation from 1981 to 1997.

Mr. Wentzell joined us as Senior Vice President and General Manager, Human Resources, in October 2004. Prior to joining us, Mr. Wentzell was Senior Vice President of Human Resources for Brooks Automation, Inc. from 2002 to 2004, following its acquisition of PRI Automation, Inc., where Mr. Wentzell served as Corporate Vice President for Human Resources from 1997 through the acquisition. Prior to that, Mr. Wentzell served as the Corporate Vice President of Human Resources for Dialogic Corporation from 1993 to 1997.

Mr. O'Brien joined us in 1978 and has held various senior management positions during this time. In 2007, Mr. O'Brien became Senior Vice President and General Manager, Business Solutions and Business Development. From 2004 to 2007, Mr. O'Brien was Vice President for Business Solutions. Prior to that, Mr. O'Brien was Vice President of Systems Engineering Group from 2001 to 2004.

The Company has adopted a code of ethics applicable to all of its directors, officers and employees including its CEO, CFO and principle accounting officer. A copy of the Company's Standards of Ethics and Conduct may be obtained free of charge through the Company's internet website at <http://www.drc.com> by choosing the "Corporate Governance" link under the "Investors" link.

If any substantive amendments are made to the Company's code of ethics or any waiver is granted, the Company intends to satisfy the disclosure requirement under Item 5.05 of Form 8-K regarding such amendment to, or waiver from, a provision of the Company's code of ethics by posting such information on its website, at the address and location specified above.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item 11 is hereby incorporated by reference to the Company's definitive proxy statement under the caption "Executive Compensation" to be filed by the Company within 120 days after the close of its fiscal year.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this Item 12 is hereby incorporated by reference to the Company's definitive proxy statement under the caption "Stock Ownership of Certain Persons" to be filed by the Company within 120 days after the close of its fiscal year.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item 13 is hereby incorporated by reference to the Company's definitive proxy statement under the caption "Other Director and Executive Officer Information" to be filed by the Company within 120 days after the close of its fiscal year.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this Item 14 is hereby incorporated by reference to the Company's definitive proxy statement under the caption "Independent Public Accountants" to be filed by the Company within 120 days after the close of its fiscal year.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULE

(a) Documents filed as part of the report:

(1) Financial Statements

The consolidated financial statements of the Company are listed in the index under Part II, Item 8 of this Annual Report on Form 10-K.

(2) Financial Statement Schedules

The Schedule II Valuation and Qualifying Accounts and Reserves of the Company are listed in the index under Part II, Item 8 of this Annual Report on Form 10-K. Other financial statements schedules are omitted because of the absence of conditions under which they are required or because the required information is given in the supplementary consolidated financial statements or notes thereto.

(3) Exhibits

The exhibits that are filed with this Annual Report on Form 10-K, or that are incorporated herein by reference, are set forth in the Exhibit Index hereto.

EXHIBIT INDEX

Exhibit No.	Description	Filed Herewith	Incorporated by Reference**	
			Form	Date
2.1	Equity Purchase Agreement among Dynamics Research Corporation and Impact Innovations Group LLC and J3 Technology Services Corp., dated August 2, 2004.		8-K	September 8, 2004
2.2	Membership Interest Purchase Agreement among Dynamics Research Corporation and Kadix Systems, LLC and Daisy D. Layman, The Sole Member of Kadix Systems, LLC, dated July 30, 2008.		8-K	August 5, 2008
3.1	Restated Articles of Organization of the Company, dated May 22, 1987.		10-Q	June 17, 1987
3.2	By-Laws of the Company, dated May 22, 1987.		10-Q	June 17, 1987
3.3	Certificate of Vote of Directors Establishing Series B Preferred Stock, dated February 17, 1998.		8-A12G	June 25, 1998
3.4	Amendment, dated September 10, 1998, to the Certificate of Vote of Directors Establishing Series B Preferred Stock.		8-A12G/A	September 30, 1998
3.5	Certificate of Vote of Directors Establishing Series A Preferred Stock, dated July 14, 1988.		10-K	December 31, 2002
3.6	Amendment, dated April 28, 1998, to the restated Articles of Organization of the Company.		10-K	December 31, 2002
3.7	Amendment, dated April 25, 2000, to the restated Articles of Organization of the Company.		10-K	December 31, 2002
3.8	Certificate of Designation with respect to the Series B Preferred Stock, par value \$.10 per share, of the Company (attached as Exhibit A to the Rights Agreement).		8-K	July 25, 2008
4.1	Specimen certificate for shares of the Company's common stock.		S-8	April 27, 2001
4.2	Rights Agreement dated as of July 23, 2008 ("Rights Agreement") between the Company and American Stock Transfer & Trust Company, as Rights Agent.		8-K	July 25, 2008
10.1	Form of indemnification agreement for directors of the Company.		10-K	December 31, 1991

Exhibit No.	Description	Filed Herewith	Incorporated by Reference**	
			Form	Date
10.2 *	Severance Agreement between John S. Anderegg, Jr. and the Company.		10-K	December 31, 1991
10.3 *	Deferred Compensation Plan for Non-Employee Directors of the Company.		10-K	December 31, 1991
10.4 *	Form of Supplemental Retirement Pension Agreement by and between the Company and Albert Rand.		10-Q	March 31, 1997
10.5 *	Amended 1995 Stock Option Plan for Non-Employee Directors.		10-Q	March 31, 1997
10.6 *	Amended 1993 Equity Incentive Plan.		10-K	December 31, 1998
10.7 *	2000 Incentive Plan.		DEFS14A	December 6, 1999
10.8 *	Employment Agreement between the Company and James P. Regan.		10-K	December 31, 1999
10.9 *	Change of Control Agreement between the Company and James P. Regan.		10-K	December 31, 1999
10.10 *	Non-qualified Stock Option Agreement between the Company and James P. Regan.		S-8	October 12, 2000
10.11 *	2000 Employee Stock Purchase Plan.		S-8	April 27, 2001
10.12 *	Special Severance Plan.		10-K	December 31, 2001
10.13 *	Senior Management Deferred Compensation Plan.		10-Q	March 31, 2002
10.14 *	Dynamics Research Corporation Special Severance Plan, as amended on May 14, 2003.		10-K	December 31, 2003
10.15 *	2003 Incentive Plan.		10-K	December 31, 2003
10.16 *	Form of grant of stock options under the 2003 Incentive Plan.		10-Q	September 30, 2004
10.17 *	Form of grant of restricted stock under the 2003 Incentive Plan.		10-Q	September 30, 2004
10.18 *	Form of grant of stock options under the 2000 Incentive Plan.		10-Q	September 30, 2004
10.19 *	Deferred Stock Compensation Plan for Non-Employee Directors, as amended for deferrals on or after January 1, 2005.		10-K	December 31, 2004

Exhibit No.	Description	Filed Herewith	Incorporated by Reference**	
			Form	Date
10.20 *	Amendment to Deferred Stock Compensation Plan for Non-Employee Directors.		10-K	December 31, 2004
10.21 *	Beneficiary Designation Form for the Deferred Compensation Plan for Non-Employee Directors.		10-K	December 31, 2004
10.22 *	Forms of grant of restricted stock under the 2000 Incentive Plan.		10-K	December 31, 2005
10.23	Purchase and Sale Agreement, dated November 18, 2005, by and between Dynamics Research Corporation and Direct Invest Property Acquisition, LLC.		8-K	January 4, 2006
10.24	Amendment to Purchase and Sale Agreement, dated December 28, 2005, by and between Dynamics Research Corporation and Direct Invest Property Acquisition, LLC.		8-K	January 4, 2006
10.25	Lease, dated December 28, 2005, by and between Dynamics Research Corporation and Direct Invest-60 Frontage, LLC.		8-K	January 4, 2006
10.26	Consent, Waiver and Amendment Agreement, dated December 28, 2005, by and among Dynamics Research Corporation, Brown Brothers Harriman & Co., KeyBank National Association, TD Banknorth, N.A., and Bank of America, N.A.		8-K	January 4, 2006
10.27	Third Amended and Restated Loan Agreement, as of September 29, 2006, by and among Dynamics Research Corporation, DRC International Corporation and H.J. Ford Associates, Inc. and Brown Brothers Harriman & Co., TD Banknorth, N.A., Bank of America, N.A.		8-K	October 4, 2006
10.28	Master Unlimited Guaranty, dated as of September 29, 2006, by each of Dynamics Research Corporation, DRC International Corporation, and H.J. Ford Associates Inc., in favor of Brown Brothers Harriman & Co., for itself and as Administrative Agent for each of the Lenders which are and which may become parties to the Loan Agreement.		8-K	October 4, 2006

Exhibit No.	Description	Filed Herewith	Incorporated by Reference**	
			Form	Date
10.29	First Amendment to Third Amended and Restated Loan Agreement by and among Dynamics Research Corporation, DRC International Corporation, and H.J. Ford Associates, Inc. and Brown Brothers Harriman & Co., TD Banknorth, N.A. and Bank of America, N.A.		8-K	May 14, 2008
10.30	Fourth Amended and Restated Loan Agreement by and among Dynamics Research Corporation, DRC International Corporation, H.J. Ford Associates, Inc., Kadix Systems, LLC as the Borrowers, and The Lenders Party hereto and Brown Brothers Harriman & Co., as Administrative Agent and TD Bank, N.A. as Documentation Agent and Bank of America, N.A. as Syndication Agent, as of August 1, 2008.		8-K	August 5, 2008
10.31	Pledge Agreement by and between Dynamics Research Corporation and Brown Brothers Harriman & Co., for itself and as Administrative Agent for each of the Lenders which are and which may become parties to the Loan Agreement, as of August 1, 2008.		8-K	August 5, 2008
10.32	First Amendment to Fourth Amended and Restated Loan Agreement by and among Dynamics Research Corporation, DRC International Corporation, H.J. Ford Associates, Inc., Kadix Systems, LLC as the Borrowers, and The Lenders Party hereto and Brown Brothers Harriman & Co., as Administrative Agent and TD Bank, N.A. as Documentation Agent and Bank of America, N.A. as Syndication Agent, as of December 31, 2008.		10-K	December 31, 2008
21.1	Subsidiaries of the registrant.	X		
23.1	Consent of Independent Registered Public Accounting Firm (Grant Thornton LLP).	X		
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	X		

<u>Exhibit No.</u>	<u>Description</u>	<u>Filed Herewith</u>	<u>Incorporated by Reference**</u>	
			<u>Form</u>	<u>Date</u>
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	X		
32.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	X		
32.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	X		

* Management contract or compensatory plan or arrangement.

** In accordance with Rule 12b-32 under the Securities Exchange Act of 1934, as amended, reference is made to the documents previously filed with the Securities and Exchange Commission, which documents are hereby incorporated by reference. The dates listed for Forms 8-A12G, Forms 8-K, Forms DEFS14A and Forms S-8 are dates the respective forms were filed on, and dates listed for Forms 10-Q and Forms 10-K are for the quarterly or annual period ended dates.

CORPORATE INFORMATION

DIRECTORS

James P. Regan
Chairman, President and
Chief Executive Officer
Dynamics Research Corporation

Dr. Francis J. Aguilar^{[3][4]}
Professor of Business Administration, Emeritus
Harvard University Graduate School
of Business Administration

John S. Anderegg, Jr.
Chairman, Emeritus
Dynamics Research Corporation

General George T. Babbitt, Jr.^{[2][3]}
USAF [Retired]

Lieutenant General Charles P. McCausland^{[1][3]}
USAF [Retired]

Nickolas Stavropoulos^[1]
Former Executive Vice President,
US Gas Distribution
National Grid

Richard G. Tennant^{[1][2]}
Former Chief Financial Officer
and Senior Vice President, iBasis, Inc. [Retired]

W. Scott Thompson^{[2][3]}
Chairman of the Board
Enterprise Solutions Group, Inc.

[1] Member of the Audit Committee

[2] Member of the Compensation Committee

[3] Member of the Nominating and
Corporate Governance Committee

[4] Lead Director

OFFICERS—CORPORATE

James P. Regan
Chairman, President and
Chief Executive Officer

David Keleher
Senior Vice President,
Chief Financial Officer and Treasurer

Jeanne D. LeFevre
Senior Vice President and General Manager,
Strategic Business Development

Lawrence H. O'Brien, Jr., Ph.D.
Senior Vice President and General Manager,
Business Development and Marketing

Steven P. Wentzell
Senior Vice President and General Manager,
Human Resources

Robert T. Alford
Vice President, Strategic Business Development
Group

Richard A. Covell
Vice President and General Counsel

David E. Kistler
Vice President and
Chief Information Officer

Shaun N. McCarthy
Vice President, Corporate Controller
and Chief Accounting Officer

Ronald Neth
Vice President and General Manager,
Contracts

OFFICERS—BUSINESS GROUPS

Robert L. Smith
Senior Vice President and General Manager,
Defense Group

Paul Strasser
Senior Vice President and General Manager,
Federal Group

Charles A. Schefer
Senior Vice President and Division General
Manager, Homeland Security Solutions Division

Kathleen A. Baird
Vice President and Division General Manager,
State and Local Group

Raymond W. Davies
Vice President and Division General Manager,
Engineering Solutions Division

Frank J. Grosso
Vice President and Division General Manager,
Defense Systems Division

Bruce A. Harris
Vice President and Division General Manager,
Readiness and Training Solutions Division

Richard Jarmusik
Vice President, CASD Financial and Regulatory
Agencies

Jerry R. Picard
Vice President and Division General Manager,
Defense Services and Solutions Division

John D. Sundius
Vice President and Division General Manager,
National Security Solutions Division

John O. Verling
Vice President and Division General Manager,
Technology Solutions Division

Irving Zaks
Vice President, Defense Group,
Strategic Development

Daphne L. Zweifel
Vice President and Division General Manager,
Civilian Agency Solutions Division

COMMON STOCK

The Company's stock is traded on the Nasdaq global market. The ticker symbol for the Company's stock is DRCO. The Company's common stock is commonly listed in newspapers as DynamR., DrnRsh, or DynRsearch.

NUMBER OF SHAREHOLDERS

The number of shareholders of record as of December 31, 2010 was 485. As of December 31, 2010 there were 10,040,029 shares outstanding.

AUDITORS

Grant Thornton LLP
226 Causeway Street
Boston, MA 02114

LEGAL COUNSEL

Nixon Peabody LLP
100 Summer Street
Boston, MA 02110

TRANSFER AGENT

**American Stock Transfer
& Trust Company, LLC**
6201 15th Avenue
Brooklyn, NY 11219
(800) 937-5449

STOCKHOLDER INFORMATION

David Keleher
Senior Vice President,
Chief Financial Officer and Treasurer
(978) 289-1615
dkeleher@drc.com

ANNUAL MEETING

The 2011 Annual Meeting of Shareholders will be held at 2:00 PM on June 1, 2011 at the offices of Nixon Peabody LLP, 100 Summer Street, Boston, MA 02110.

SAFE HARBOR STATEMENTS UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995:

Some statements contained or implied in this annual report which are not historical fact such as financial forecasts contain forward-looking information. These statements may be identified by forward-looking words such as "anticipates," "believes," "estimates," "expects," "intends," "plans," "projects," "may," "will," "should," and other similar expressions. Such statements are subject to risks and uncertainties that could cause actual results to differ materially from these forward-looking statements, including uncertainties regarding contractual requirements, actions by customers and actual costs to complete, federal budget matters, government contracting risks, competitive market conditions, customer requirements, schedules and related funding, technological change, uncertainty of future financing, overall economic factors, ability to successfully complete and integrate acquisitions, and other matters discussed in the Company's filings with the SEC. These factors are discussed in more detail in the Company's most recent Annual Report on Form 10-K. The Company assumes no obligation to update forward-looking information.



DYNAMICS RESEARCH CORPORATION
Two Tech Drive
Andover, Massachusetts 01810-2434
P 800 522 4321 or 978 289 1500 / F 978 289 1887
www.drc.com