HALIFAX CORP OF VIRGINIA
Form 10-Q
February 17, 2009

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

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2008
OR

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

For the transition period from _____ to _____

Commission file Number 1-08964
Halifax Corporation of Virginia

(Exact name of registrant as specified in its charter)

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

(703) 658-2400

(Registrant s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

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

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company þ

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. There were 3,175,206 shares of common stock outstanding as of January 23, 2009

HALIFAX CORPORATION OF VIRGINIA

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Item 1. Financial Statements

HALIFAX CORPORATION OF VIRGINIA
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(Amounts in thousands, except share data)	December 31, 2008	March 31, 2008
ASSETS		
CURRENT ASSETS		
Cash	$ 846	$ 232
Accounts receivable, net	5,389	10,206
Inventory, net	2,809	3,240
Prepaid expenses and other current assets	246	220
TOTAL CURRENT ASSETS	9,290	13,898
PROPERTY AND EQUIPMENT, net	852	1,001
GOODWILL	2,918	2,918
OTHER INTANGIBLE ASSETS, net	446	662
OTHER ASSETS	59	111
TOTAL ASSETS	$ 13,565	$ 18,590
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 2,066	$ 2,807
Accrued expenses	2,441	2,473
Deferred maintenance revenues	1,936	4,309
Current portion of long-term debt	327	276
Bank debt	1,987	4,448
Auxiliary line of credit		60
Income taxes payable	96	35
TOTAL CURRENT LIABILITIES	8,853	14,408
SUBORDINATED DEBT AFFILIATE	1,000	1,000
OTHER LONG-TERM DEBT	216	325
DEFERRED INCOME	55	99
TOTAL LIABILITIES	10,124	15,832

COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY		
Preferred stock, no par value Authorized 1,500,000, none issued or outstanding		
Common stock, $.24 par value Authorized 6,000,000 shares,		
Issued 3,431,890 as of December 31, 2008 and March 31, 2008, respectively		
Outstanding 3,175,206 shares as of December 31, 2008		
and March 31, 2008, respectively	828	828
Additional paid-in capital	9,096	9,075
Accumulated deficit	(6,271)	(6,933)
Less treasury stock at cost 256,684 shares	(212)	(212)
TOTAL STOCKHOLDERS EQUITY	3,441	2,758
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 13,565	$ 18,590

See accompanying Notes to Condensed Consolidated Financial Statements.

HALIFAX CORPORATION OF VIRGINIA
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE AND NINE MONTHS ENDED DECEMBER 31, 2008 AND 2007 (UNAUDITED)

(Amounts in thousand, except share and per share data)	Three Months Ended December 31, 2008	Three Months Ended December 31, 2007	Nine Months Ended December 31, 2008	Nine Months Ended December 31, 2007
Revenues	$ 8120	$ 10,494	$ 26,043	$ 34,880
Operating costs and expenses	6,826	10,195	21,835	31,545
Gross margin	1,294	299	4,208	3,335
Selling and marketing	183	211	587	681
General and administrative	793	903	2,639	2,747
Provision for loss from settlement of litigation		410		410
Transaction costs		458		458
Operating income (loss)	318	(1,683)	982	(961)
Other income	(1)	(8)	(2)	(27)
Interest expense	80	155	256	534
Income (loss) before income taxes	239	(1,830)	728	(1,468)
Income tax expense	7	5	66	30
Net income (loss)	$ 232	$ (1,835)	$ 662	$ (1,498)
Earnings (loss) per share basic	$ .07	$ (.58)	$ .21	$ (.47)
Earnings (loss) per share diluted	$ .07	$ (.58)	$ .21	$ (.47)
Weighted average number of shares outstanding				
Basic	3,175,206	3,175,206	3,175,206	3,175,206
Diluted	3,175,206	3,175,206	3,176,166	3,175,206

See accompanying Notes to Condensed Consolidated Financial Statements.

HALIFAX CORPORATION OF VIRGINIA
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED DECEMBER 31, 2008 AND 2007 (UNAUDITED)

(Amounts in thousands)	Nine Months Ended December 31, 2008	2007
Cash flows from operating activities:		
Net income (loss)	$ 662	$ (1,498)
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	608	665
Share-based compensation	21	19
Changes in operating assets and liabilities:		
Accounts receivable	4,817	2,742
Inventory	431	1,201
Prepaid expenses and other assets	26	381
Accounts payable and accrued expenses	(773)	(1,110)
Income taxes payable	61	51
Deferred maintenance revenue	(2,373)	(827)
Deferred income	(44)	(45)
Net cash provided by operating activities	3,436	1,579
Cash flows from investing activities:		
Acquisition of property and equipment	(81)	(353)
Restricted cash		(23)
Net used in investing activities	(81)	(376)
Cash flows from financing activities:		
Proceeds from bank borrowing	25,606	32,030
Payment of bank debt	(28,067)	(32,974)
Payment of auxiliary line of credit	(60)	(75)
Payment of other long-term debt	(220)	(23)
Net cash used in financing activities	(2,741)	(1,042)
Net increase in cash	614	161

Cash at beginning of period	232	1,078
Cash at end of period	$ 846	$ 1,239
Supplemental Disclosure of Cash Flow Information:		
Cash paid for interest	$ 196	$ 520
Cash paid for income taxes	$ 4	$ 6
Purchase of equipment under capitalized lease	$ 162	$

See accompanying Notes to Condensed Consolidated Financial Statements.

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

Note 1 Basis of Presentation

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

The accompanying financial statements present the Company s financial position, results of operations, and cash flows on a consolidated basis. The unaudited consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Wholly-owned subsidiaries include Halifax Engineering, Inc. and Halifax Realty, Inc. All significant intercompany transactions are eliminated in consolidation.

The accompanying unaudited consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission and in accordance with the accounting principles generally accepted in the United States of America (GAAP) for interim financial reporting. Certain information and footnote disclosures normally included in the annual financial statements have been omitted pursuant to those rules and regulations.

In the opinion of management, the accompanying unaudited consolidated financial statements reflect all necessary adjustments and reclassifications (all of which are of a normal, recurring nature) that are necessary for fair presentation for the periods presented. The Accounting Policies followed by the Company with respect to unaudited interim financial statements are consistent with those stated in the Company s annual report on Form 10-K. The accompanying March 31, 2008 financial statements were derived from the Company s audited financial statements. The results for the three and nine months ended December 31, 2008, are not necessarily indicative of the results to be expected for the full fiscal year. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company s annual report on Form 10-K for the year ended March 31, 2008 filed with the Securities and Exchange Commission.

Management s Plans

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

The Company is continuing to focus on its core high availability logistics and maintenance services business while at the same time evaluating its future strategic direction. Management must also continue to emphasize operating efficiencies through cost containment strategies, reengineering efforts and improved service delivery techniques. The Company s cost containment strategies included reductions in its workforce, consolidating and reducing its leased facilities, company-wide salary and wage reduction and reductions of other operating expenses in order to align expenses as a result of losses in revenue. During the three and nine months ended December 31, 2008, the Company benefited from the cost actions undertaken during the last part of fiscal year 2008. The Company has also began marketing its enterprise logistic service offering and began to migrate away from contracts where there is a high degree of exposure to inventory obsolescence.

The industry in which the Company operates continues to experience unfavorable economic conditions and competitive challenges. The Company continues to experience significant price competition and customer demand for higher service attainment levels. In addition, there is significant price competition in the market for state and local government contracts as a result of budget issues, political pressure and other factors beyond the Company s control.

Fair Value Measurements

On April 1 2008, the Company adopted Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standard (SFAS) No. 157, Fair Value Measurements , which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. SFAS No. 157 does not require any new fair value measurements, but rather eliminates inconsistencies in guidance found in various other accounting pronouncements. The adoption of SFAS No. 157 did not have a material effect on the Company s financial condition or operating results.

On April 1, 2008, the Company also adopted SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115 . SFAS No. 159 allows companies to choose to measure eligible financial instruments and certain other items at fair value that are not required to be measured at fair value. SFAS No. 159 requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings at each reporting date. The Company adopted SFAS No. 159 but has not elected the fair value option for any eligible financial instruments as of December 31, 2008.

Note 2 Accounts Receivable

Trade accounts receivable consist of:

(Amounts in thousands)	December 31, 2008	March 31, 2008
Amounts billed	$ 5,378	$ 10,283
Amounts unbilled	255	73
Allowance for doubtful accounts	(244)	(150)
Accounts receivable, net	$ 5,389	$ 10,206

Note 3 Inventory

Inventory consists principally of spare parts, computers and computer peripherals, hardware and software. Inventory is recorded net of an allowance for obsolescence of $957,000 at December 31, 2008 and $1.2 million at March 31, 2008.

Note 4 Goodwill and Other Intangible Assets

Under Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets (SFAS 142), goodwill is tested for impairment annually, or more frequently, if events or changes in circumstances indicate that the carrying amount of the asset might be impaired. The goodwill impairment test is a two-step process which requires the Company to make judgmental assumptions regarding fair value. Testing is required between annual tests if events occur or circumstances change that would, more likely than not, reduce the fair value of the reporting unit below its carrying value. Such an event may occur if, for an extended period of time, the market value of the Company s common stock were less than the carrying value of the Company.

Management also reviews the Company s financial position quarterly for other triggering events as described in SFAS No. 142. Should actual results not meet expectations or assumptions change in future years, the impairment assessment could result in a lower fair value estimate which could result in an impairment charge that may materially affect the carrying value of the Company s assets and results from operations.

Impairment is assessed at the reporting unit level by applying a fair value-based test. A reporting unit is defined as the same as or one level below the operating segment level as described in SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information. The Company has one reporting unit, in the test and measurement business, because none of the components of the Company constitute a business for which discrete financial information is available and for which Company management regularly reviews the results of operations.

The first step is to identify if an impairment of goodwill has occurred by comparing the fair value of the reporting unit with its carrying amount, including goodwill. If the fair value of the reporting unit exceeds its carrying amount, goodwill of the reporting unit is not considered impaired. If the carrying amount of the reporting unit exceeds its fair value, the second step of the goodwill test is performed to measure the amount of the impairment loss, if any. In this second step, the implied fair value (as defined in SFAS 142) of the reporting unit s goodwill is compared with the carrying amount of the goodwill. If the carrying amount of the reporting unit s goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess, not to exceed the carrying amount of the goodwill.

The Company completed the annual impairment test required under SFAS 142 as of December 31, 2008 and determined that the fair value of the reporting unit exceed its carrying amount, including goodwill. As the Company consists of only one reporting unit, and is publicly traded, management estimates of the fair value was prepared by weighting three different valuation methods: the discounted cash flow method, the mergers and acquisition method and an indication to value based on the quoted market price of the Company s stock. The Company heavily weighted the discounted cash flow method and the mergers and acquisition method in determining the fair value of the reporting unit. Due to the lack of an active trading market for the Company s stock, the Company s quoted market price was not considered as strong an indication of value of the reporting unit.

If the Company s revenues and cost forecasts are not achieved, the Company fails to have continued profitability and market acceptance, or the market conditions in the stock market cause the valuation to decline, the Company may incur charges for impairment of goodwill. A significant impairment could result in additional charges and have a material adverse impact on the consolidated financial condition and operating results.

Note 5 Accounts Payable

Accounts payable represents amounts owed to third parties at the end of the period. The Company included drafts outstanding in accounts payable of approximately $515,000 and $659,000 at December 31, 2008 and March 31, 2008, respectively.

Note 6 Tax Matters

Deferred tax assets and liabilities on the balance sheets reflect the net tax effect of temporary differences between carrying amounts of assets and liabilities for financial statement purposes and the amounts used for income tax purposes. The deferred tax assets and liabilities are classified on the balance sheets as current or non-current based on the classification of the related assets and liabilities.

Management regularly evaluates the realizability of its deferred tax assets given the nature of its operations and the tax jurisdictions in which it operates. The Company adjusts its valuation allowance from time to time based on such evaluations. Based upon the Company s historical taxable income, when adjusted for non-recurring items, net operating loss carryback potential and estimates of future profitability, management has concluded that, in its judgment, the deferred tax asset should remain fully reserved at December 31, 2008.

The Company adopted FASB Interpretation No. 48 (FIN 48), ″Accounting for Uncertainty in Income Taxes , as of April 1, 2007. This standard modifies the previous guidance provided by FASB Statement No. 5 (FAS 5), ″Accounting for Contingencies and FASB No. 109 (FAS 109), ″Accounting for Income Taxes for uncertainties related to the Company s income tax liabilities . The Company has analyzed its income tax posture using the criteria required by FIN 48 and concluded that there is a $20,000 cumulative effect inclusive of penalty and interest allocable to equity or derecognition of deferred tax assets as a result of adopting this standard. The adjustment was due to potential exposure arising from increases in state income taxes in higher tax rate states from lower tax rate states as a result of differing methodologies that may be applied for apportionment.

There was no increase recorded through December 31, 2008 related to material changes to the measurement of unrecognized tax benefits in various taxing jurisdictions. The Company is maintaining its historical method of not accruing interest (net of related tax benefits) and penalties associated with unrecognized income tax benefits as a component of income tax expense. Interest expense and penalty expense related to income taxes, if any, are included in interest expense and general and administrative expenses, respectively, in the consolidated statements of operations. For the three and nine months ended December 31, 2008, the Company has not recorded any material interest or penalty expense related to income taxes. The total amount of unrecognized tax benefits as of December 31, 2008, if

recognized, would have a $20,000 effect on income tax expense and would impact the effective tax rate.

The tax return years from 1999 forward in the Company s major tax jurisdictions are not settled as of December 31, 2008; no changes in settled tax years have occurred through December 31, 2008. Due to the existence of tax attribute carryforwards (which are currently offset by a full valuation allowance), the Company treats certain post-1999 tax positions as unsettled due to the taxing authorities ability to modify these attributes.

The Company estimates that it is reasonably possible that no reduction in unrecognized tax benefits may occur in the next twelve months due primarily to the expiration of the statute of limitations in various state and local jurisdictions. The Company does not currently estimate any additional material reasonably possible uncertain tax positions occurring within the next twelve-month time frame.

Note 7 Debt Obligations

On July 1, 2008, the Company entered into a Loan and Security Agreement, referred to as the Loan Agreement, with Textron Financial Corporation. The Loan Agreement replaced the Fourth Amended and Restated Loan and Security Agreement dated as of June 29, 2007 (as amended by the First Amendment and Waiver dated November 13, 2007, the Second Amendment and Waiver dated January 31, 2008 and the Third Amendment and Waiver dated April 30, 2008) with Provident Bank, which terminated on June 30, 2008, referred to as the Old Credit Facility. Generally, under the revolving credit facility of the Loan Agreement, the Company may borrow an amount equal to the lesser of (a) $4,000,000 or (b) the sum of (i) up to the eligible accounts advance rate of the aggregate amount of eligible accounts and (ii) up to the eligible pre-billed accounts rate of the aggregate amount of eligible pre-billed accounts in an amount not to exceed the eligible pre-billed accounts sublimit. As of December 31, 2008 the Company had approximately $2.0 million available under its credit facility.

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

Subordinated Debt Affiliates

The Arch C. Scurlock Children s Trust (the Children s Trust) and Nancy M. Scurlock each own 392,211 shares of the Company s common stock or 25% in the aggregate of the Company s outstanding common stock. The Arch C. Scurlock Children s Trust and Nancy M. Scurlock are affiliates of the Company (Affiliates). Both are greater than 10% shareholders of the Company s outstanding common stock. Arch C. Scurlock, Jr., a beneficiary and trustee of the Children s Trust, and John H. Grover, a trustee of the Children s Trust, are the Company s directors. The holders of the 8% promissory notes are the Children s Trust and Nancy M. Scurlock. The Company s 8% promissory notes are subordinated to the Loan Agreement described above.

The Company s 8% promissory notes maturity date was extended to July 1, 2009. As of December 31, 2008, the aggregate principal balance of the 8% promissory notes was $1.0 million.

The Company s Loan Agreement requires the lender s approval for the payment of dividends or distributions as well as the payment of principal or interest on the Company s outstanding subordinated debt, which is held by the Affiliates. Interest expense on the subordinated debt owned by the Affiliates is accrued on a current basis.

The balance of accrued but unpaid interest due on the 8% promissory notes to the Affiliates was approximately $282,000 at December 31, 2008.

Note 8 Stock Based Compensation and Earnings per Share

During the quarter ended December 31, 2008, there were no grants of stock options to purchase shares of common stock under the Company s 2005 Stock Option and Incentive Plan. There were no terminations/expirations of options during the three months ended December 31, 2008 and 1,600 terminations/expirations of options and no exercises of options to purchase shares of the Company s common stock during the nine month period ended December 31, 2008.

The following table summarizes the information for options outstanding and exercisable under the Company s 2005 Stock Option and Incentive Plan at December 31, 2008.

Range of Exercise Prices	Options Outstanding	Options Outstanding Weighted Average Remaining Contractual Life	Options Outstanding Weighted Average Exercise Price	Options Exercisable	Options Exercisable Weighted Average Exercise price
$ .66	12,000	9.69 years	$ .66		$
3.40	27,800	6.69 years	3.40	27,800	3.40
3.00	61,400	7.55 years	3.00	24,800	3.00
	101,200		$ 2.83	52,600	$ 3.21

The following table summarizes the information for options outstanding and exercisable under the Company s 1994 Key Employee Stock Option Plan and Non-Employee Directors Stock Option Plan at December 31, 2008. For the three months ended December 31, 2008 there were 500 terminations of options and no exercises of options and for the nine months then ended, there were terminations/expirations of 12,310 options and no exercises of options to purchase shares of the Company s common stock. No grants may be made under the 1994 Key Employee Stock Option Plan or Non-Employee Directors Stock Option Plan.

Range of Exercise Prices	Options Outstanding	Options Outstanding Weighted Average Remaining Contractual Life	Options Outstanding Weighted Average Exercise Price	Options Exercisable	Options Exercisable Weighted Average Exercise price
$5.50-7.56	72,000	1.03 years	$ 6.14	72,000	$ 6.14
5.38-7.06	64,000	1.49 years	5.81	64,000	5.81
1.80-4.05	70,000	2.92 years	3.51	70,000	3.51
3.10-5.00	45,667	3.93 years	3.51	45,667	3.51
4.11	13,000	4.55 years	4.57	13,000	4.57
4.45-5.02	76,690	5.60 years	4.11	76,690	4.11
	341,357		$ 4.76	341,357	$ 4.76

The intrinsic value of stock options outstanding at December 31, 2008 was $0.
As of December 31, 2008, there was $52,500 of total unrecognized compensation cost related to nonvested share-based compensation arrangements. This cost is expected to be fully amortized in five years.
For the nine months ended December 31, 2008 and 2007, the Company recorded share based compensation expense of approximately $21,000 and $19,000, respectively.

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

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

(Amounts in thousands except share data.)	Three Months Ended December 31, 2008	Three Months Ended December 31, 2007	Nine Months Ended December 31, 2008	Nine Months Ended December 31, 2007
Numerator for earning per share:				
Net income (loss)	$ 232	$ (1,835)	$ 662	$ (1,498)
Denominator:				
Denominator for basic earnings per share weighted-average shares	3,175,206	3,175,206	3,175,206	3,175,206
Effect of dilutive securities:				
Employee stock options			960	
Denominator for diluted earnings per share weighted number of shares Outstanding	3,175,206	3,175,206	3,176,166	3,175,206
Basic (loss) earnings per common share	$ .07	$ (.58)	$ .21	$ (.47)
Diluted (loss) earnings per common share	$ .07	$ (.58)	$ .21	$ (.47)

Note 9 Recent accounting pronouncements

During the first quarter of fiscal 2009, the Company adopted SFAS No. 157, Fair Value Measurements, which defines fair value, provides a framework for measuring fair value, and expands the disclosures required for fair value measurements. In February 2008, the FASB issued FASB Staff Position (FSP) No. FAS 157-2, Effective Date of FASB Statement No. 157. FSP 157-2 delays the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008 for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) and will be adopted by the Company beginning in the first quarter of fiscal 2010. Although the Company will continue to evaluate the application of FSP 157-2, management does not currently believe adoption will have a material impact on the Company s financial condition or operating results.

In December 2007, FASB issued SFAS No. 141 (revised 2007), Business Combinations, which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree in a business combination. SFAS No. 141R also establishes principles around how goodwill acquired in a business combination or a gain from a bargain purchase should be recognized and measured, as well as provides guidelines on the disclosure requirements on the nature and financial impact of the business combination. SFAS No. 141R is effective for fiscal years beginning on or after December 15, 2008 and will be adopted by the Company beginning in the first quarter of fiscal 2010. Management does not currently believe adoption will have a material impact on the Company s financial condition or operating results.

Note 10 Commitments and Contingencies

There are no material pending legal proceedings to which the Company is a party. The Company is engaged in ordinary routine litigation incidental to the Company s business to which the Company is a party. While we cannot predict the ultimate outcome of these various legal proceedings, it is management s opinion that the resolution of these matters should not have a material effect on our financial position or results of operations.

On May 15, 2008, the NYSE Alternext (Alternext), formerly the American Stock Exchange granted us an extension until September 14, 2009 to regain compliance with the continued listing standards. As previously disclosed we had received notice from the Alternext staff indicating that the Company was below certain of the Exchange s continuing listing standards (losses in three out of four of its most recent fiscal years with shareholders equity below $4 Million) of the Alternext Company Guide. We were afforded the opportunity to submit a plan of compliance to the Exchange and on April 14, 2008, presented its plan to Alternext. On May 15, 2008, Alternext notified the Company that it had accepted the Company s plan of compliance and granted the Company an extension until September 14, 2009 to regain compliance with the continued listing standards. We will be subject to periodic review by the Exchange Staff during the extension period. Failure to make progress consistent with the plan or failure to regain compliance with the continued listing standards by the end of the extension period could result in us being delisted from the NYSE Alternext.

During the three months ended December 31, 2008, we retained an advisor to assist us in our plan to regain compliance with the continued listing standards of the American Stock exchange. We are committed to pay $100,000 in fees for advisory services. As of December 31, 2008 we paid $80,000 of these advisory fees.

During the three months ended December 31, 2008, we entered into non-cancelable leases with unrelated third parties for software and related maintenance, and hardware. The total fair market value of this software was approximately $87,000 with a lease term of four years. The total fair market value of the hardware was approximately $75,000 with a lease term of three years. These leases were classified as capital lease obligations.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

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

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

Overview

Halifax delivers enterprise logistics and supply chain solutions from front-office customer interaction to back-office reverse logistics. We deliver comprehensive, fully integrated services including end-to-end customer support and fulfillment, critical inventory optimization and management, web-based customized reporting, onsite repair services, as well as depot repair and warranty management. We also provide nationwide high availability, multi-vendor, enterprise maintenance service provider for enterprises, including businesses, global service providers, governmental agencies and other organizations. We have undertaken significant changes to our business in recent years.

We offer a growing list of services to businesses, global service providers, governmental agencies, and other organizations. Our services are customized to meet each customer s needs providing 7x24x365 service, personnel with required security clearances for certain governmental programs, project management services, depot repair and roll out services. We believe the flexible services we offer to our customers enable us to tailor a solution to obtain maximum efficiencies within their budgeting constraints.

When we are awarded a contract to provide services, we may incur expenses before we receive any contract payments. This may result in a cash short fall that may impact our working capital and financing. This may also cause fluctuations in operating results as start-up costs are expensed as incurred.

Our goal is to maintain profitable operations, expand our customer base of clients through our existing global service provider partners, seek new global service provider partners and enhance the technology we utilize to deliver cost-effective services to our growing customer base. We must also effectively manage expenses in relation to revenues by directing new business development towards markets that complement or improve our existing service lines. We must continue to emphasize operating efficiencies through cost containment strategies, re-engineering efforts and improved service delivery techniques, particularly within costs of services, selling, marketing and general

and administrative expenses.

Management s Plans

We are continuing to focus on our core high availability logistics and maintenance services business while at the same time evaluating our future strategic direction. Management must also continue to emphasize operating efficiencies through cost containment strategies, reengineering efforts and improved service delivery techniques. Our cost containment strategies included reductions in force, consolidating and reducing our leased facilities, company-wide salary and wage reduction and reductions of other operating expenses in order to align expenses as a result of losses in revenue. During the three and months nine ended December 31, 2008, we benefited from the cost actions undertaken during the last part of fiscal year 2008. We also began marketing our enterprise logistic service offering and began to migrate away from contracts where there is a high degree of exposure to inventory obsolescence.

The industry in which we operate continues to experience unfavorable economic conditions and competitive challenges. We continue to experience significant price competition and customer demand for higher service attainment levels. In addition, there is significant price competition in the market for state and local government contracts as a result of budget issues, political pressure and other factors beyond our control.

Results of Operations

The following discussion and analysis provides information management believes is relevant to an assessment and understanding of our consolidated results of operations for the three and nine months ended December 31, 2008 and 2007, respectively, and should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto.

(amounts in thousands, except share data)	Three months ended December 31,				Nine months ended December 31,			
Results of Operations	2008	2007	Change	%	2008	2007	Change	%
Revenues	$ 8,120	$ 10,494	(2,374)	-22.6	$ 26,043	$ 34,880	(8,837)	-25.3
Operating costs and expenses	6,826	10,195	3,369	333.0	21,835	31,545	9,710	30.8
Percent of revenues	84%	97%			84%	90%		
Gross margin	1,294	299	995	332.8%	4,208	3,335	873	26.1%
Percent of revenues	16%	3%			16%	10%		
Selling and marketing	183	211	28	13.3	587	681	94	14%
Percent of revenues	2%	2%			2%	2%		
General & administrative	793	903	110	12.2	2,639	2,747	108	3.9
Percent of revenues	10%	9%			10%	8%		
Provision for loss on settlement of litigation		410	410	N/M		410	410	N/M
Transaction costs		458	458	N/M		458	458	N/M
Operating (loss) income	318	(1,683)	2,001	629%	982	(961)	1,943	197%
Percent of revenues	4%	(16%)			4%	(3%)		
Other income	(1)	(8)	(7)	-88	(2)	(27)	(25)	-92%
Interest expense	80	155	75	49%	256	534	278	52%
Income (loss) before income tax	239	(1,830)	2,069	865%	728	(1,468)	2,196	301%
Income tax expense	7	5	(2)	-40%	66	30	(36)	120%
Net income (loss)	$ 232	$ (1,835)	$ 2,067	891%	$ 662	$ (1,498)	$ 2,160	326%
Earnings per share basic:	$ .07	$ (.58)			$ .21	$ (.47)		

Earnings per share diluted:	$ .07	$ (.58)	$ .21	$ (.47)	
Weighted average number of common shares outstanding					
Basic	3,175,206	3,175,206	3,175,206	3,175,206	
Diluted	3,175,206	3,175,206	3,176,166	3,175,206	

Revenues

Revenues are generated from the sale of enterprise logistic services, high availability enterprise maintenance services and technology deployment (consisting of professional services, seat management and deployment services, and product sales). Services revenues include monthly recurring fixed unit-price contracts as well as time-and-material contracts. Amounts billed in advance of the services period are recorded as unearned revenues and recognized when earned. The revenues and related expenses associated with product held for resale are recognized when the products are delivered and accepted by the customer.

The composition of revenues for:

	Three months ended December 31,				Nine months ended December 31,			
(in thousands)	2008	2007	Change	%	2008	2007	Change	%
Services	$ 7,922	$ 9,907	$ (1,985)	-20.0%	$ 25,150	$ 33,011	$ (7,861)	-23.8%
Product held for resale	198	587	(389)	-66.2%	893	1,869	(976)	-52.2
Total Revenue	$ 8,120	$ 10,494	$ (2,374)	-22.6%	$ 26,043	$ 34,880	$ (8,837)	-25.3%

Revenues from services for the three months ended December 31, 2008 decreased 20%, or $2.0 million, to $7.9 million from $9.9 million. For the nine months ended December 31, 2008 revenues from services decreased $7.9 million, or 24% from $33.0 million to $25.1 million. The decrease in services revenues was attributable to the termination of certain large nation-wide enterprise maintenance contracts, including the loss of a large aeronautic manufacturing customer, partially offset by new higher margin business.

For the three months ended December 31, 2008, product held for resale decreased $389,000, or 66%, from $587,000 to $198,000. For the nine months ended December 31, 2008 product held for resale decreased 52% or $1,869,000 to $893,000. The decrease was attributable to several large one-time orders last year which did not reoccur during the three and nine months ended December 31, 2008. We continue to de-emphasize product sales and intend to focus on our recurring services revenue model. As a result, we do not expect to see any material increases in product sales in future periods.

Revenues for the three months ended December 31, 2008 decreased 23%, or $2.4 million, to $8.1 million from $10.5 million. Revenues for the nine months ended December 31, 2008 decreased $8.8 million or 25% from $34.8 million compared to $26.0 for 2008. The decrease in revenues was the result of the termination of several contracts and the de-emphasis on product sales, partially offset by new higher margin business.

Operating costs and expenses

Included within operating costs and expenses are direct costs, including fringe benefits, product and part costs, and other costs.

A large part of our service costs are support costs and expenses that include direct labor and infrastructure costs to support our service offerings. We continue to aggressively pursue cost containment strategies and augment our service delivery process with automation tools.

On long-term fixed unit-price contracts, part costs vary depending upon the call volume received from customers during the period. Many of these costs are volume driven and as volumes increase, these costs as a percentage of revenues increase, negatively impacting profit margins.

The variable components of costs associated with fixed price contracts are part costs, overtime, subcontracted labor, mileage reimbursed, and freight. Parts costs are highly variable and dependent on several factors, based on the types of equipment serviced, equipment age and usage, and environment. On long-term fixed unit-price contracts, parts and peripherals are consumed on service calls.

For installation services and seat management services, product may consist of hardware, software, cabling and other materials that are components of the service performed. Product held for resale consists of hardware and software.

Operating costs and expenses were comprised of the following components:

	Three months ended December 31,				Nine months ended December 31,			
(in thousands)	2008	2007	Change	%	2008	2007	Change	%
Services	$ 6,644	$ 9,680	$ 3,036	31.3%	$ 21,021	$ 29,846	$ 8,825	29.5%
Product held for resale	182	515	333	64.6%	814	1,699	885	52.0%
Total Operating costs and expenses	$ 6,826	$ 10,195	$ 3,369	39.1%	$ 21,835	$ 31,545	$ 9,710	30.8%

Total operating costs and expenses for the three months ended December 31, 2008 decreased $3.3 million, to $6.8 million, or 39%, from $10.1 million for the same period in 2007. Total operating costs and expenses for the nine months ended December 31, 2008 decreased $9.7 million, or 31% from $31.5 million to $21.8 million. The reduction in costs was related to the corresponding reduction in revenue, as well as cost containment efforts, and a shift away from contracts with a high degree of inventory risk. In addition, due to several contract losses last year, we incurred a $1.0 million charge for obsolete inventory for the three and nine months ended December 31, 2007.

We continue to expand the use of automation tools introduced earlier in the year, which we believe, in conjunction with our on-going cost containment efforts, will reduce our cost to deliver services to our customers. We believe these tools will enable us to enter new markets which will positively affect our gross margins going forward.

Costs for product held for resale have decreased $333,000, from $515,000 for the three months ended December 31, 2007 to $182,000. For the nine months ended December 31, 2008 product held for resale decreased 52%, or $885,000 to $814,000. The decrease in costs for products held for resale was commensurate with the reductions in revenue.

Gross Margin

For the three months ended December 31, 2008, our gross margins increased 332%, or $995,000, from $299,000 for the period ended December 31, 2008 to $1.3 million. For the nine months ended December 31, 2008 gross margin increased approximately $900,000 or 26% from $3.3 million to $4.2 million. As a percentage of revenue, gross margins improve to 16% for the three and nine months ended December 31, 2008 compared to 3% and 10% for the respective periods last year. As discussed above the improvement in gross margins was attributable to a shift in our business model away from high concentrations in part costs and its associated inventory obsolescence risk, the introduction of our enterprise solution offering, cost containment strategies, and a onetime charge to increase the inventory obsolescence during last fiscal that did not reoccur this year.

Selling and Marketing Expense

Selling and marketing expense consists primarily of salaries, commissions, travel costs and related expenses. Selling and marketing expense was $183,000 for the three months ended December 31, 2008 compared to $211,000 for the three months ended December 31, 2007, a decrease of $28,000, or 13%. For the nine months ended December 31, 2008 selling and marketing decreased $94,000 from $681,000 to $587,000, a decrease of 14%. The decrease in selling and marketing expense was the result of reduced personnel costs and lower commission expense.

General and Administrative Expense

Our general and administrative expenses consist primarily of non-allocated overhead costs. These costs include executive salaries, accounting, contract administration, professional services such as legal and audit, business insurance, occupancy and other costs.

For the three months ended December 31, 2008, general and administrative expenses decreased $110,000 to $793,000 compared to $903,000, a decrease of 12% for the same period last year. For the nine months ended December 31, 2008, general and administrative expenses decreased approximately $100,000 to $2.6 million compared to $2.7 million for the nine months ended December 31, 2007. For the three months and nine months ended December 31, 2008, the decrease in general and administrative expense when compared to last year was attributable to

decreases in professional fees related to compliance with Sarbanes-Oxley and SEC reporting last year and reductions in occupancy costs offset by increased bank fees associated with obtaining new financing and higher

depreciation expense related to the automation tools discussed above when compared to the same period last year. Various factors such as changes in the markets due to economic conditions, employee costs and benefits, and costs associated with complying with existing Securities and Exchange Commission regulations related to SOX and American Stock Exchange requirements may increase general and administrative expenses and have a negative impact on our earnings in future periods.

We account for stock-based compensation in accordance with Statement of Financial Accounting Standards 123(R) (SFAS 123(R)), *Share-Based Payments*. Under the fair value recognition provisions of this statement, share-based compensation cost is measured at the grant date based on the value of the award and recognized as expense over the vesting period. Determining the fair value of the share-based awards at the grant date requires judgment, including estimated volatility, dividend yield, expected term and estimated forfeitures of the options granted and are included in general and administrative expense. For each of the three months ended December 31, 2008 and 2007, we reported compensation expense of approximately $8,000 and $7,500 and $21,000 and $19,000 of expense for the nine months ended December 31, 2008 and 2007, respectively.

Litigation Expense

In order to avoid the ongoing cost of litigation, on February 4, 2008, we settled the outstanding lawsuit with Indus. As a result of recognizing the gain on the sale of our Secure Network Services division during the fiscal year ended March 31, 2007, we incurred a charge for $410,000, resulting in a charge to operations during the three and nine months ended December 31, 2007.

Transaction costs

In early 2007, we indentified a potential acquisition opportunity and coupled with an equity investment which would have increased our size to better enable us to compete in the enterprise maintenance market. Due to changes in market and valuation issues, we determined not to pursue this target in December 2007. As a result, we recorded a charge to operations of $458,000 for transaction related costs.

Interest Expense

Interest expense for the three months ended December 31, 2008 was $80,000 compared to $115,000 for the same period in 2007. Interest for the nine months ended December 31, 2008 decreased $278,000 from $534,000 to $256,000 compared to the nine months ended December 31, 2007. The primary reason for the decrease in interest expense during the three and nine months ended December 31, 2008 was the result of decreases in the amount of borrowings during the current period when compared to the same periods last year.

Income Tax Expense

For the three months ended December 31, 2008, we recorded income tax expense of $7,000 compared to $5,000 for the same period in 2007. For the nine months ended December 31, 2008, $66,000 was recorded compared to $30,000 the nine months ended December 31, 2007. Our income tax expense consists primarily of state taxes. The Company has a net operating loss carry forward of approximately $5.6 million which expires from 2019 through 2027.

Net income (loss)

For the three months ended December 31, 2008, the net income was $232,000 compared to a net loss of $1.8million for the comparable period in 2007. For the nine months ended December 31, 2008, net income was $662,000 compared to a net loss of 1.5 million for the nine month period ended December 31, 2007, an increase of $2.1million. As discussed above, the improvement in our operating results, were the result of reduced operating costs related to cost containment strategies affording us higher margins, and non- recurring charges last year for inventory obsolescence, transaction costs and litigation.

Liquidity and Capital Resources

As of December 31, 2008, we had approximately $846,000 of cash on hand. Sources of our cash for the three and nine months ended December 31, 2008 have been from operations and our revolving credit facility.

We anticipate that our primary sources of liquidity will be cash generated from operating income and cash available under our new loan agreement with Textron Financial Corporation (see below).

Cash generated from operations may be affected by a number of factors. See Item 1A. and Risk Factors in our Form 10-K for the year ended March 31, 2008.

On July 1, 2008, we entered into a new Loan Agreement with Textron Financial Corporation. The Loan Agreement replaced the Old Credit Facility which terminated on June 30, 2008.

The Loan Agreement has a term of three years (this three year term is referred to as the initial term) and will automatically renew after the completion of the initial term for additional one year terms unless terminated by the lender or us. We may terminate the Loan Agreement by giving written notice of termination to the Lender at least 90 days prior to the end of the relevant term. The Lender may terminate the Loan Agreement at the expiration of the initial term or any renewal term by giving written notice of termination at least 60 days prior to the effective date of the termination and at any time during the existence of an event of default. We may terminate the Loan Agreement early upon payment in full of the principal amount outstanding and any other obligations we owe to the Lender provided that we pay an early termination fee of 2% of the credit limit if we terminate the Loan Agreement within the first year of the Loan Agreement (if termination is caused by a change in control, the percentage will be reduced to 1%) and such termination fee is reduced to 1% of the credit limit if terminated after the first year of the Loan Agreement. The lender is also entitled to the early termination fee upon an occurrence of an event of default relating to our becoming insolvent or bankrupt, even if the lender does not exercise its right of termination.

Under the revolving credit facility of the Loan Agreement, we may borrow an amount equal to the lesser of (a) $4,000,000 or (b) the sum of (i) up to the eligible accounts advance rate of the aggregate amount of eligible accounts and (ii) up to the eligible pre-billed accounts rate of the aggregate amount of eligible pre-billed accounts in an amount not to exceed the eligible pre-billed accounts sublimit. The lender may establish reserves against the amount we may borrow as it determines in its sole discretion are necessary to reflect events, conditions, contingencies or risks which may affect the collateral securing the revolving credit facility or our financial condition. The lender may also reduce the eligible accounts advance rate to a lesser amount the lender determine in its sole credit discretion if our borrower s dilution at any time exceeds the maximum dilution percentage. The eligible accounts advance rate, eligible pre-billed accounts, eligible pre-billed accounts sublimit, eligible accounts, collateral, dilution and maximum dilution are defined in the Loan Agreement. Advances under the Loan Agreement are collateralized by a first priority security interest on all of our personal property as set forth in the Loan Agreement. Each of Halifax Engineering, Inc., Halifax Realty, Inc. and Halifax Alphanational Acquisition, Inc. are guarantors under the Loan Agreement. Additionally, Charles McNew, the Company s President and Chief Executive Officer and Joseph Sciacca, the Company s Vice President, Finance and Chief Financial Officer, have limited personal guarantees under the Loan Agreement. As of December 31, 2008, our outstanding balance under the loan agreement was $1.9 million and we had availability approximately $2.0million.

Interest accrues on the outstanding balance at a variable rate, adjusted daily, equal to prime plus 2.75%. The prime rate generally means the greater of (a) 5% or (b) the prime commercial rate of interest per annum as announced from time to time on-line by the Wall Street Journal. All interest accrued on the outstanding principal balance will be calculated on the basis of a year of 360 days and the actual number of days elapsed in each month. Upon an event of default, the interest rate on the unpaid balance will immediately be increased by 3%. We must pay accrued interest monthly, in arrears. Accrued interest and fees will be added to the unpaid principal amount on the day such amounts are due, unless the lender elects to invoice us for such amounts. At December 31, 2008, the interest rate was 7.75%.

We are required to pay to the lender a monthly servicing fee of $2,500. We are also required to pay a credit facility fee in the amount of 1.0% of the credit limit, which was due on the effective date of the Loan Agreement and 0.5% on each anniversary of the effective date of the Loan Agreement. We will also be required to pay a field examination fee for each fee examination performed by the lender.

We must pay to the lender all cash receipts received by us. Following credit for collected funds, the lender has 3 business days as float days for which it may not apply such funds against the principal outstanding. The lender is entitled to charge us for the float days at the interest rate on all collections received. We must maintain a lock-box for collection of accounts at a bank designated by the lender. The lender may charge our accounts or advance funds under the revolving credit facility to make any payments of principal, interest, fees, costs or expenses required to be made by us under the Loan Agreement.

Events of default, include, but are not limited to: (i) our failure to make a payment on any obligation of borrowed money or other indebtedness or observe a convent which results in the payment of such obligation to be due before its stated maturity, (ii) the lender determining that an adverse change has occurred in our financial condition or business prospects

or the prospect for payment or performance of any covenant, agreement or obligation under the Loan Agreement is impaired, (iii) bankruptcy, reorganization or insolvency proceedings are instituted by or against us, (iv) a settlement, judgment or order for the payment of money by us in excess of $100,000, (v) any loss, theft, damage or destruction of any item or items of collateral or our other property which materially and adversely affects the property, business, operations, prospects, or condition of us, (vi) an over advance arises which was not approved by lender, and (vii) we move any collateral to, or stores or maintains any collateral at, any location other than as stated in the Loan Agreement.

The Loan Agreement provides that upon the occurrence of an event of default, the lender may, without notice, (i) discontinue making any further advances under the revolving credit facility, (ii) terminate the Loan Agreement, (iii)declare all our obligations under the Loan Agreement, including principal amount outstanding and accrued interest, to be immediately due and payable, (iv) take possession of all or any portion of the collateral, (v) use, without charge, any of our patents, copyrights, trade names, trade secrets, trademarks, advertising materials or any license therefore or any property of a similar nature, in advertising for sale and selling any of the collateral, (vi) renew, modify or extend any account, grant waivers or indulgences with respect to any account, accept partial payments on any account, release, surrender or substitute any security for payment of any account or compromise with, or release, any person liable on any account in such a manner as lender may, in its sole discretion deem advisable, all without affecting or diminishing our obligations; and (vii) obtain the appointment of a receiver, trustee, or similar official over us to effect all of the transactions contemplated by the Loan Agreement or as is otherwise necessary to perform the Loan Agreement. Additionally, the Loan Agreement provides that upon the occurrence of an event of default, the lender may, with notice, sell or otherwise dispose of all or any portion of the collateral at public or private sale for cash or credit.

The Loan Agreement contains representations, warranties and covenants that are customary in connection with a transaction of this type. The Loan Agreement contains certain covenants including, but not limited to: (i) notifying the lender of any amounts due and owing in excess of $50,000 that are in dispute by any account debtor on an eligible account or eligible pre-billed account, (ii) the immediate payment of any excess amount above the credit limit plus accrued interest and other charges owed with respect to such excess amount, (iii) in the event accounts arise out of government contracts, we will assign to the lender all amounts due under government contracts, (iv) we may not make a change in management, enter into any merger or consolidation, or liquidate, wind up or dissolve , or convey, lease, sell, transfer or otherwise dispose of any substantial portion of our business or property or acquire all or substantially all of the assets or business of any other company, person or entity, (v) without lender s prior written consent, we may not encumber the collateral in favor of any person other than lender, other than (a) the permitted prior encumbrances on equipment; or (b) liens permitted under the terms of any intercreditor agreements, (vi) without lender s prior written consent, we may not sell, consign, lease, license or remove from our business locations any of our assets except that, so long as no event of default has occurred, we may sell inventory in the ordinary course of our business (any sale or exchange of inventory in satisfaction of our indebtedness will not be a sale of inventory in the ordinary course of business) and may sell or dispose of obsolete assets which we have determined, in good faith, not to be useful in the conduct of our business and which, in any fiscal year, do not have an aggregate fair market value in excess of the $100,000, (vii) we may not make any loan or contribute money, goods or services to any person, or borrow money or incur any indebtedness from any person, or guaranty or agree to become liable for any obligation of, any person, other than: (a) loans to our employees for reimbursable expenses incurred by such employees in the normal course of our business; (b) extensions of credit in the ordinary course of business to our customers; (c) purchase money indebtedness incurred solely for the purchase of equipment; and (d) indebtedness identified in the Loan Agreement, (viii) we may not make capital expenditures of any kind or nature, including leases of property which are required to be capitalized on our balance sheet, in an aggregate amount in excess of the $250,000 in any fiscal year, (ix) we may not declare or pay any dividend upon, make any distribution with respect to, or purchase, redeem or otherwise acquire any of our capital stock or increase, whether by election, promotion or otherwise, the aggregate salaries and other compensation paid to our officers by more than 10% in any fiscal year, (x) we may not cause, permit, or suffer, directly or indirectly a change in control (as defined in the Loan Agreement), (xi) we may not enter into or be a party to certain agreements and transactions with an interested party (as defined in the Loan Agreement) or borrower

affiliate (as defined in the Loan Agreement), and (xii) we may not make any payment with respect to indebtedness that is subordinate to our obligations under the Loan Agreement except as specifically provided for in an intercreditor agreement. The Loan Agreement also contains certain financial covenants which we are required to maintain including, but not limited to, maintaining an adjusted tangible net worth that is not less than $0 and not permit our accounts receivable turnover days to exceed 75 days.

We were in compliance with the covenants of our Loan Agreement at December 31, 2008. There can be no assurances we will be able to comply with the covenants or other terms contained in the Loan Agreement. We may not be

successful in obtaining a waiver of non-compliance with these financial covenants. If we are unable to comply with the covenants or other terms of the Loan Agreement, absent a waiver, we will be in default of the Loan Agreement and the lender can take any of the actions discussed above.

Our revenues will continue to be impacted by the loss of customers due to price competition and technological advances. Our future financial performance could be negatively affected by unforeseen factors and unplanned expenses. See Item 1A. and Risk Factors in our Form 10-K for the year ended March 31, 2008.

In furtherance of our business strategy, transactions we may enter into could increase or decrease our liquidity at any point in time. If we were to obtain a significant contract or make contract modifications, we may be required to expend our cash or incur debt, which will decrease our liquidity. Conversely, if we dispose of assets, we may receive proceeds from such sales which could increase our liquidity. From time to time, we may entertain discussions concerning acquisitions and dispositions which, if consummated, could impact our liquidity, perhaps significantly.

We expect to continue to require funds to meet remaining interest and principal payment obligations, capital expenditures and other non-operating expenses. Our future capital requirements will depend on many factors, including revenue growth, expansion of our service offerings and business strategy.

At December 31, 2008 we had working capital of $437,000 and at March 31, 2008, we had a deficit in working capital of $510,000, respectively. The current ratio was 1.05 at December 31, 2008 compared to .96 at March 31, 2008.

Capital expenditures for the nine months ended December 31, 2008 were $81,000 as compared to $353,000 for the same period in 2007. We anticipate fiscal year 2009 technology requirements to result in capital expenditures totaling approximately $250,000. We continue to sublease a portion of our headquarters building which reduces our rent expense by approximately $400,000 annually.

Our subordinated debt agreements with Nancy Scurlock and the Arch C. Scurlock Children s Trust, which are referred to as affiliates, totaled $1.0 million at December 31, 2008. Pursuant to a subordination agreement between Textron Financial Corporation and the subordinated debt holders, principal repayment and interest payable on the subordinated debt agreements may not be paid without the consent of Textron Financial Corporation. On December 31, 2008, each of the affiliates referred to above, held $500,000 face amounts of our 8% promissory notes, with an aggregate outstanding principal balance of $1.0 million. Interest payable to the affiliates was approximately $282,000 at December 31, 2008. The 8% promissory notes mature on July 1, 2009.

If any act of default occurs, the principal and interest due under the 8% promissory notes issued under the subordinated debt agreement will be due and payable immediately without any action on behalf of the note holders and if not cured, could trigger cross default provisions under our loan agreement with Textron Financial Corporation If we do not make a payment of any installment of interest or principal when it becomes due and payable, we are in default. If we breach or default in the performance of any covenants contained in the notes and continuance of such breach or default for a period of 30 days after the notice to us by the note holders or breach or default in any of the terms of borrowings by us constituting superior indebtedness, unless waived in writing by the holder of such superior indebtedness within the period provided in such indebtedness not to exceed 30 days, we would be in default on the 8% promissory notes.

Off Balance Sheet Arrangements

In conjunction with a government contract, we act as a conduit in a financing transaction on behalf of a third party. We routinely transfer receivables to a third party in connection with equipment sold to end users. The credit risk passes to the third party at the point of sale of the receivables. Under the provisions of Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*, transfers were accounted for as sales, and as a result, the related receivables have been excluded from the accompanying consolidated balance sheets. The amount paid to us for the receivables by the transferee is equal to our carrying value and therefore there is no gain or loss recognized. The end user remits its monthly payments directly to an escrow account held by a third party from which payments are made to the transferee and us, for various services provided to the end users. We provide limited monthly servicing whereby we invoice the end user on behalf of the transferee. The off-balance sheet transactions had no impact on our liquidity or capital resources. We are not aware of any event, demand or uncertainty that would likely terminate the agreement or have an adverse affect on our operations.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

The definitive extent of the interest rate risk is not quantifiable or predictable because of the variability of future interest rates and business financing requirements. We do not customarily use derivative instruments to adjust our interest rate risk profile.

The information below summarizes our sensitivity to market risks as of December 31, 2008. The table presents principal cash flows and related interest rates by year of maturity of our funded debt. The carrying value of our debt approximately equals the fair value of the debt. Note 6 to the consolidated financial statements in our annual report on Form 10-K for the year ended March 31, 2008 contains descriptions of funded debt and should be read in conjunction with the table below.

(In thousands)		December 31, 2008
Debt obligations		
Revolving credit agreement at the prime rate plus 1/4%. Due September 30, 2008. Interest rate at December 31, 2008 of 7.75%.	$	1,987
Total variable rate debt		1,987
8% subordinated notes payable to affiliate due July 1, 2009		1,000
Long Term lease payable		504
Total fixed rate debt		1,504
Total debt	$	3,491

At December 31, 2008, we had approximately $3.5 million of debt outstanding of which $1.5 million bore fixed interest rates. If the interest rates charged to us on our variable rate debt were to increase significantly, the effect could be materially adverse to our current and future operations.

We conduct a limited amount of business overseas, principally in Western Europe. At the present, all transactions are billed and denominated in U.S. dollars and consequently, we do not currently have any material exposure to foreign exchange rate fluctuation risk.

Item 4T. Controls and Procedures

Quarterly Evaluation of the Company s Disclosure Controls and Internal Controls. The Company evaluated the effectiveness of the design and operation of its disclosure controls and procedures as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the Act), as of the end of the period covered by this Form 10-Q (Disclosure Controls). This evaluation (Disclosure Controls Evaluation) was done under the supervision and with the participation of management, including the Chief Executive Officer (CEO) and Chief Financial Officer (CFO).

The Company s management, with the participation of the CEO and CFO, also conducted an evaluation of the Company s internal control over financial reporting, as defined in Rule 13a-15(f) of the Act, to determine whether any changes occurred during the period ended December 31, 2008 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting (Internal Controls Evaluation).

Limitations on the Effectiveness of Controls. Control systems, no matter how well conceived and operated, are designed to provide a reasonable, but not an absolute, level of assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. The Company conducts periodic evaluation of its internal controls to enhance, where necessary, its procedures and controls.

Conclusions. The Company s CEO and CFO concluded that the Company s disclosure controls and procedures were not effective as of December 31, 2008 in reaching a reasonable level of assurance that (i) information required to be disclosed by the Company in the reports that it files or submits under the Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms and (ii) information required to be disclosed by the Company in the reports that it files or submits under the Act is accumulated and communicated to the Company s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. The company previously reported on Form 10K for the year ended March 31, 2008 there were two material weaknesses in our internal controls over financial reporting. The Company is in the process of remediating these weaknesses.

There were no changes in internal controls over financial reporting as defined in Rule 13a-15(f) of the Act that have materially affected, or are reasonably likely to materially affect internal controls over the Company s internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 1A. Risk Factors

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

None

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

None

Item 5. Other Information

None

Item 6. Exhibits

Exhibit 31.1	Certification of Charles L. McNew, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2	Certification of Joseph Sciacca, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32.1	Certification of Charles L. McNew, Chief Executive Officer, pursuant to 18 U.S.C. Section 1350 (Section 906 of the Sarbanes-Oxley Act of 2002)
Exhibit 32.2	Certification of Joseph Sciacca, Chief Financial Officer, pursuant to 18 U.S.C. Section 1350 (Section 906 of the Sarbanes-Oxley Act of 2002)

SIGNATURES

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

HALIFAX CORPORATION OF VIRGINIA
(Registrant)

Date: February 17, 2009

By: /s/ Charles L. McNew
Charles L. McNew
President & Chief Executive Officer
(principal executive officer)

Date: February 17, 2009

By: /s/ Joseph Sciacca
Joseph Sciacca
Vice President, Finance &
Chief Financial Officer
(principal financial officer)