

PARADIGM HOLDINGS, INC

FORM 10-Q (Quarterly Report)

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

FORM 10-Q

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

For the quarterly period ended March 31, 2009

OR

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

For the transition period from _____ to _____

Commission File Number 000-09154

PARADIGM HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

WYOMING

(State or other jurisdiction
of incorporation or organization)

83-0211506

(IRS Employer Identification No.)

9715 KEY WEST AVE., 3RD FLOOR
ROCKVILLE, MARYLAND

(Address of principal executive offices)

20850

(Zip Code)

(301) 468-1200

(Registrant's telephone number, including area code)

None

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

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer (do not check if a smaller reporting company) 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

Shares of common stock outstanding on May 8, 2009 were 43,868,027 .

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PART I: FINANCIAL INFORMATION

Item 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

**PARADIGM HOLDINGS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS**

	March 31, 2009	December 31, 2008
	(unaudited)	
ASSETS		
Current assets		
Cash and cash equivalents	\$ —	\$ 52,257
Accounts receivable — contracts, net	6,704,173	6,920,768
Prepaid expenses	919,206	1,033,837
Prepaid corporate income taxes	46,320	47,092
Deferred income tax assets	28,247	60,269
Other current assets	378,624	554,610
Total current assets	8,076,570	8,668,833
Property and equipment, net	162,051	183,612
Goodwill	3,991,605	3,991,605
Intangible assets, net	1,157,773	1,244,591
Deferred financing costs, net	1,008,780	—
Deferred income tax assets, net of current portion	318,862	211,326
Other non-current assets	128,918	172,029
Total Assets	\$ 14,844,559	\$ 14,471,996
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Bank overdraft	\$ 411,413	\$ —
Note payable — line of credit	4,019,658	5,949,983
Note payable — promissory note	—	2,000,000
Capital leases payable, current portion	—	1,578
Accounts payable and accrued expenses	1,893,681	3,498,690
Accrued salaries and related liabilities	1,327,042	1,474,133
Mandatorily redeemable preferred stock, current portion	50,000	—
Other current liabilities	170,210	227,200
Total current liabilities	7,872,004	13,151,584
Long-term liabilities		
Other non-current liabilities	165,530	183,870
Mandatorily redeemable preferred stock - \$.01 par value, 10,000,000 shares authorized, 6,206 shares issued and outstanding as of March 31, 2009	4,324,077	—
Put warrants	1,971,058	—
Total liabilities	14,332,669	13,335,454
Commitments and contingencies		
Convertible preferred stock - \$.01 par value, 10,000,000 shares authorized, 0 and 1,800 shares issued and outstanding as of March 31, 2009 and December 31, 2008, respectively. Each share of convertible preferred stock has a liquidation preference of \$0.01 per share plus all accrued but unpaid dividends	—	18
Common stock - \$.01 par value, 50,000,000 shares authorized, 40,943,027 shares and 19,148,153 shares issued and outstanding as of March 31, 2009 and December 31, 2008, respectively	409,431	191,482
Additional paid-in capital	3,000,496	3,215,400
Accumulated deficit	(2,898,037)	(2,270,358)
Total stockholders' equity	511,890	1,136,542
Total liabilities and stockholders' equity	\$ 14,844,559	\$ 14,471,996

The accompanying Notes to the Condensed Consolidated Financial Statements are an integral part of these condensed consolidated financial statements.

PARADIGM HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended	
	March 31, 2009	March 31, 2008
Contract Revenue		
Service contracts	\$ 5,578,538	\$ 7,046,526
Repair and maintenance contracts	2,129,087	3,750,372
Total contract revenue	<u>7,707,625</u>	<u>10,796,898</u>
Cost of revenue		
Service contracts	4,318,086	5,476,142
Repair and maintenance contracts	1,868,484	3,217,550
Total cost of revenue	<u>6,186,570</u>	<u>8,693,692</u>
Gross margin	1,521,055	2,103,206
Selling, general and administrative	1,830,318	2,157,155
Loss from operations	<u>(309,263)</u>	<u>(53,949)</u>
Other income (expense)		
Interest income	4	624
Change in fair value of put warrants	(42,891)	—
Interest expense – mandatorily redeemable preferred stock	(133,276)	—
Interest expense	(216,547)	(265,610)
Total other expense	<u>(392,710)</u>	<u>(264,986)</u>
Loss from operations before income taxes	(701,973)	(318,935)
Benefit for income taxes	<u>(74,294)</u>	<u>(81,447)</u>
Net loss	(627,679)	(237,488)
Dividends on preferred stock	78,870	45,000
Net loss attributable to common shareholders	<u>\$ (706,549)</u>	<u>\$ (282,488)</u>
Weighted average number of common shares:		
Basic	26,413,111	19,148,153
Diluted	26,413,111	19,148,153
Basic and diluted net loss per common share	\$ (0.03)	\$ (0.01)

The accompanying Notes to the Condensed Consolidated Financial Statements are an integral part of these condensed consolidated financial statements.

PARADIGM HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months Ended March 31,	
	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$ (627,679)	\$ (237,488)
Adjustments to reconcile net loss to net cash used in operating activities:		
Share-based compensation	161,468	140,031
Depreciation and amortization	112,379	178,436
Bad debt recovery	—	(16,176)
Amortization of deferred financing costs	30,891	—
Interest expense for accretion of warrant discount	33,429	—
Accretion of preferred stock	41,373	—
Change in fair value of put warrants	42,891	—
Deferred income taxes	(75,514)	(69,956)
(Increase) Decrease in		
Accounts receivable - contracts, net	216,595	(763,107)
Prepaid expenses	109,631	(146,646)
Prepaid corporate income taxes	772	(60,548)
Other current assets	175,986	39,659
Other non-current assets	8,111	(109,291)
(Decrease) Increase in		
Accounts payable and accrued expenses	(1,736,943)	(371,741)
Accrued salaries and related liabilities	(147,091)	(74,627)
Other current liabilities	(56,990)	173,437
Other non-current liabilities	(18,340)	(49,828)
Net cash used in operating activities	<u>(1,729,031)</u>	<u>(1,367,845)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Cash paid for business acquisition	—	(87,339)
Purchase of property and equipment	(3,999)	(12,802)
Net cash used in investing activities	<u>(3,999)</u>	<u>(100,141)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Bank overdraft	411,413	(897,215)
Payments on capital leases	(1,578)	(9,290)
Payment on notes payable	(2,000,000)	(18,228)
Proceeds from mandatorily redeemable preferred stock	6,206,000	—
Preferred stock issuance costs	(822,737)	—
Dividends paid on Series A Preferred Stock	(75,000)	(45,000)
Repurchase of Series A Preferred Stock	(107,000)	—
Proceeds from line of credit	12,029,434	18,752,088
Payments on line of credit	(13,959,759)	(16,294,585)
Net cash provided by financing activities	<u>1,680,773</u>	<u>1,487,770</u>
Net (decrease) increase in cash and cash equivalents	(52,257)	19,784
Cash and equivalents, beginning of period	52,257	7,771
Cash and cash equivalents, end of period	<u>\$ —</u>	<u>\$ 27,555</u>

For the three months ended March 31,

2009

2008

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Cash paid during the quarter:

Cash paid for income taxes	\$ 98	\$ 51,178
Cash paid for interest	\$ 325,918	\$ 279,277

Non-cash financing activities:

Conversion of Series A preferred stock to common stock	\$ 1,191,771	\$ —
Preferred stock issuance costs incurred but not paid	\$ 176,934	\$ —
Dividends declared but not paid	\$ —	\$ 45,000

The accompanying Notes to the Condensed Consolidated Financial Statements are an integral part of these condensed consolidated financial statements.

PARADIGM HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

Paradigm Holdings, Inc. (the "Company") is the parent of the wholly owned subsidiaries, Paradigm Solutions Corp., Trinity IMS, Inc. ("Trinity") and Caldwell Technology Solutions, LLC ("CTS"). Reference is made to the Annual Report on Form 10-K for the Company for the year ended December 31, 2008 filed with the Securities and Exchange Commission (the "SEC") for additional information on our corporate structure.

The interim condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the SEC. Therefore, certain financial information and footnote disclosures accompanying annual financial statements prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") are omitted in this interim report. The interim condensed consolidated financial statements and notes thereto should be read in conjunction with the Annual Report on Form 10-K for the Company for the year ended December 31, 2008.

The accompanying unaudited condensed consolidated financial statements for the Company reflect all normal recurring adjustments that are necessary, in the opinion of management, to present fairly the results of operations in accordance with GAAP. All significant intercompany accounts and transactions have been eliminated in consolidation. The results for the interim periods are not necessarily indicative of the results to be expected for the fiscal year.

Liquidity

As of March 31, 2009, the Company had an accumulated deficit of approximately \$2.9 million and working capital of \$0.2 million. Additionally, the Company is dependent on a line-of-credit financing arrangement. Although there can be no assurances, the Company believes that cash flow from operations, together with borrowings available from our credit facility with Silicon Valley Bank ("SVB") and the combination of in-process cost reductions along with the completion of fundraising activities on February 27, 2009 will be adequate to meet future liquidity needs for the next twelve months.

For a description of the Company's accounting policies, refer to Note 1 of the Notes to Consolidated Financial Statements of the Annual Report on Form 10-K for Paradigm Holdings, Inc. for the year ended December 31, 2008.

Revenue Recognition

Substantially all of the Company's revenue is derived from service and solutions provided to the federal government by Company employees and subcontractors.

The Company generates its revenue from three different types of contractual arrangements: (i) time and materials contracts, (ii) cost-plus reimbursement contracts, and (iii) fixed price contracts.

Time and Materials ("T&M"). For T&M contracts, revenue is recognized based on direct labor hours expended in the performance of the contract by the contract billing rates and adding other billable direct costs.

Cost-Plus Reimbursement ("CP"). Under CP contracts, revenue is recognized as costs are incurred and include an estimate of applicable fees earned. For award based fees under CP contracts, the Company recognizes the relevant portion of the expected fee to be awarded by the client at the time such fee can be reasonably estimated and collection is reasonably assured based on factors such as prior award experience and communications with the client regarding performance.

Fixed Price ("FP"). The Company has two basic categories of FP contracts: (i) fixed price-level of effort ("FP-LOE") and (ii) firm fixed price ("FFP").

- Under FP-LOE contracts, revenue is recognized based upon the number of units of labor actually delivered multiplied by the agreed rate for each unit of labor. Revenue on fixed unit price contracts, where specific units of output under service agreements are delivered, is recognized as units are delivered based on the specific price per unit. For FP maintenance contracts, revenue is recognized on a pro-rata basis over the life of the contract.
- Under FFP contracts, revenue is generally recognized subject to the provision of the SEC Staff Accounting Bulletin (“SAB”) No. 104, “Revenue Recognition.” For those contracts that are within the scope of the American Institute of Certified Public Accountants (“AICPA”) Statement of Position (“SOP”) 81-1, “Accounting for Performance of Construction-Type and Certain Production-Type contracts”, revenue is recognized on the percentage-of-completion method using costs incurred in relation to total estimated costs.

In certain arrangements, the Company enters into contracts that include the delivery of a combination of two or more of its service offerings. Such contracts are divided into separate units of accounting and revenue is recognized separately in accordance with the Company's revenue recognition policy for each element. Further, if an arrangement requires the delivery or performance of multiple deliveries or elements under a bundled sale, the Company determines whether the individual elements represent “separate units of accounting” under the requirements of Emerging Issues Task Force Issue (“EITF”) No.00-21, “Revenue Arrangements with Multiple Deliverables”, and allocates revenue to each element based on relative fair value.

Software revenue recognition for sales of OpsPlanner is in accordance with AICPA SOP 97-2, “Software Revenue Recognition.” Since the Company has not yet established vendor specific objective evidence of fair value for the multiple elements typically contained within an OpsPlanner sale, revenue from the sale of OpsPlanner is recognized ratably over the term of the contract. The OpsPlanner software was sold as part of the sale of the commercial business on February 28, 2007. Effective March 1, 2007, the Company is the exclusive reseller of the OpsPlanner software to the federal government.

In certain contracts, revenue includes third-party hardware and software purchased on behalf of clients. The level of hardware and software purchases made for clients may vary from period to period depending on specific contract and client requirements. The Company recognizes the gross revenue under EITF No. 99-19, “Reporting Revenue Gross as a Principal versus Net as an Agent”, for certain of its contracts which contain third-party products and services, because in those contracts, the Company is contractually bound to provide a complete solution which includes labor and additional services in which the Company maintains contractual, technical and delivery risks for all services and agreements provided to the customers, and the Company may be subject to financial penalties for non-delivery.

The Company is subject to audits from federal government agencies. The Company has reviewed its contracts and determined there is no material risk of any significant financial adjustments due to government audit. To date, the Company has not had any adjustments as a result of a government audit of its contracts.

Revenue recognized on contracts for which billings have not yet been presented to customers is included in unbilled receivables.

Deferred revenue relates to contracts for which customers pay in advance for services to be performed at a future date. The Company recognizes deferred revenue attributable to its software and maintenance contracts over the related service periods.

Cost of Revenue

Cost of revenue for service contracts consists primarily of labor, consultant, subcontract, materials, travel expenses and an allocation of indirect costs attributable to the performance of the contract.

Cost of revenue for repair and maintenance contracts consist primarily of labor, consultant, subcontract, materials, travel expenses and an allocation of indirect costs attributable to the performance of the contract. Certain costs are deferred based on the recognition of revenue for the associated contracts.

Goodwill and Intangible Assets

Goodwill represents the excess of cost over the fair value of net assets acquired in business combinations. Pursuant to the provisions of Statement of Financial Accounting Standards (“SFAS”) No. 142, “Goodwill and Other Intangible Assets”, goodwill and intangible assets with indefinite lives are not amortized, but instead are tested for impairment at least annually. SFAS No. 142 also requires that identifiable intangible assets with estimable useful lives be amortized over their estimated useful lives, and reviewed for impairment in accordance with SFAS No. 144, “Accounting for Impairment or Disposal of Long-Lived Assets.”

The Company conducts a review for impairment of goodwill and intangible assets annually in the fourth quarter. Additionally, on an interim basis, the Company assesses the impairment of goodwill and intangible assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors that the Company considers important which could trigger an impairment review include significant underperformance relative to historical or expected future operating results significant changes in the manner or use of the acquired assets or the strategy for the overall business, significant negative industry or economic trends or a decline in a company's stock price for a sustained period. Goodwill and intangible assets are subject to impairment to the extent the Company's operations experience significant negative results. These negative results can be the result of the Company's individual operations or negative trends in the Company's industry or in the general economy, which impact the Company. To the extent the Company's goodwill and intangible assets are determined to be impaired then these balances are written down to their estimated fair value on the date of the determination.

Share-based Compensation

The Company follows the provisions of SFAS No. 123R, “Share-Based Payment”, to account for share-based compensation. Option awards granted after January 1, 2006 and those previously granted, but for which vesting provisions had not been met, are valued at fair value based on the Black-Scholes option-pricing model and the fair value is recognized as an expense on a straight line basis over the requisite service period. Restricted common stock granted after January 1, 2006 is valued at fair value based on the closing market price on the date of grant. Total share-based compensation expense included in selling, general and administrative expenses in the accompanying condensed consolidated statements of operations was \$161 thousand and \$140 thousand for the three months ended March 31, 2009 and 2008, respectively, including the expense recognized for the restricted common stock issued on October 21, 2008 and May 3, 2007. The Company did not grant any share-based awards for the three months ended March 31, 2009 and 2008.

Valuation of Warrants

The Company accounts for the issuance of common stock purchase warrants in accordance with the provisions of EITF 00-19. The Class A Warrants and Class B Warrants issued in connection with the sale of the Company's Series A-1 Senior Preferred Stock, par value \$0.01 per share (the “Series A-1 Preferred Stock”), contain a provision that could require cash settlement and that event is outside the control of the Company, and therefore are classified as a liability as of March 31, 2009. The Company assesses classification of put warrants at each reporting date to determine whether a change in classification is required. The Company values put warrants using the Black-Scholes valuation model. Put warrants are valued upon issuance, and re-valued at each financial statement reporting date. Any change in value is charged to other income or expense during the period.

Major Customers

Nearly all of the Company's revenue is from federal agencies and 73% and 68% of total revenue was generated from three major customers during the three months ended March 31, 2009 and 2008, respectively. The Company's accounts receivable related to these major customers was 65% and 63% of total accounts receivable at March 31, 2009 and at December 31, 2008, respectively. The Company defines major customer by agencies within the federal government.

A majority of the Company's customer concentration is in the Mid-Atlantic states of the United States.

Segment Reporting

SFAS No. 131, "Disclosure about Segments of an Enterprise and Related Information", establishes standards for the way that public business enterprises report information about operating segments in annual financial statements and requires that these enterprises report selected information about operating segments in interim financial reports. SFAS No. 131 also establishes standards for related disclosures about products and services, geographic areas and major customers. Management has concluded that the Company operates in one segment based upon the information used by management in evaluating the performance of its business and allocating resources and capital.

Recent Accounting Pronouncements – Not Yet Adopted

In April 2009, the Financial Accounting Standards Board ("FASB") issued FASB Staff Positions ("FSP") No. 157-4 ("FSP No. 157-4"), "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly," which provides additional guidance for estimating fair value in accordance with SFAS No. 157, "Fair Value Measurements" when the volume and level of activity for the asset or liability have significantly decreased. This FSP re-emphasizes that regardless of market conditions the fair value measurement is an exit price concept as defined in SFAS No. 157. This FSP clarifies and includes additional factors to consider in determining whether there has been a significant decrease in market activity for an asset or liability and provides additional clarification on estimating fair value when the market activity for an asset or liability has declined significantly. The scope of this FSP does not include assets and liabilities measured under level 1 inputs. The Company will adopt FSP No. 157-4 effective June 30, 2009. The adoption of FSP No. 157-4 is not expected to have a material impact on the Company's statements of operations, financial position or cash flows.

In April 2009, the FASB issued FSP No. 107-1 and APB 28-1, "Interim Disclosures about Fair Value of Financial Instruments." This FSP which amends SFAS No. 107, "Disclosures about Fair Value of Financial Instruments," requires publicly-traded companies, as defined in APB Opinion No. 28, "Interim Financial Reporting," to provide disclosures on the fair value of financial instruments in interim financial statements. The Company will adopt FSP No. 107-1 and APB 28-1 effective June 30, 2009. The adoption of FSP No. 107-1 and APB 28-1 is not expected to have a material impact on the Company's statements of operations, financial position or cash flows.

In April 2009, the FASB issued FSP No. 115-2 and No. 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments." FSP No. 115-2 and No. 124-2 changes the method for determining whether an other-than-temporary impairment exists for debt securities and the amount of the impairment to be recorded in earnings. The Company will adopt FSP No. 115-2 and No. 124-2 effective June 30, 2009. The adoption of FSP No. 115-2 and No. 124-2 is not expected to have a material impact on the Company's statements of operations, financial position or cash flows.

Recent Accounting Pronouncements – Adopted

On January 1, 2009, the Company adopted SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133." The statement modifies and expands the disclosure requirements for derivative instruments and hedging activities. SFAS No. 161 requires that objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation and requires quantitative disclosures about fair value amounts and gains and losses on derivative instruments. It also requires disclosures about credit-related contingent features in derivative agreements. The adoption of SFAS No. 161 did not have a material impact on the Company's statements of operations, financial position or cash flows.

On January 1, 2009, the Company adopted SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements." The statement establishes the accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. The adoption of SFAS No. 160 did not have a material impact on the Company's statements of operations, financial position or cash flows as the Company does not have any noncontrolling interests in other active companies.

On January 1, 2009, the Company adopted SFAS No. 141 (revised 2007), "Business Combinations." The statement establishes principles and requirements for how the acquirer recognizes and measures the identifiable assets acquired, the goodwill acquired, the liabilities assumed and any noncontrolling interest in the acquiree and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. This standard did not have immediate impact upon adoption by the Company, but will result in items such as transaction and acquisition related-restructuring costs with respect to business combinations closing after December 31, 2008 being charged to expense when incurred. The Company will consider this standard when evaluating potential future transactions to which it would apply.

On January 1, 2009, the Company adopted FSP No. 157-2, “Effective Date of FASB Statement No. 157.” FSP No. 157-2 applies to nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in an entity’s financial statements on a recurring basis (at least annually) and defers the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008 for items within the scope of this FSP. The adoption of FSP No. 157-2 did not have a material impact on the Company’s statements of operations, financial position or cash flows.

On January 1, 2009, the Company adopted FSP No. 142-3, “Determination of the useful life of intangible assets.” FSP No. 142-3 amends the factors that should be considered in developing the renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, “Goodwill and Other Intangible Assets.” FSP No. 142-3 also requires additional disclosures on information that can be used to assess the extent to which future cash flows associated with intangible assets are affected by an entity’s intent or ability to renew or extend such arrangements and on associated accounting policies. The adoption of FSP No. 142-3 may impact the Company in the future if the Company acquires intellectual property or other assets.

On January 1, 2009, the Company adopted FSP APB 14-1, “Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement).” FSP APB 14-1 requires issuers of convertible debt to account separately for the liability and equity components of these instruments if they have stated terms permitting cash settlement upon conversion. This practice marks a significant change from the current accounting practice for convertible debt instruments in the scope of the FSP. Current practice does not require separation of the liability and equity components of such instruments. Separately accounting for these instruments’ liability and equity components results in the recording of more interest cost over the life of the convertible debt instrument, because of an initial debt discount. The adoption of FSP APB 14-1 did not have a material impact on the Company’s statements of operations, financial position or cash flows.

On January 1, 2009, the Company adopted FSP EITF 03-6-1, “Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities.” FSP EITF 03-6-1 clarifies that all outstanding unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents, whether paid or unpaid, are participating securities. An entity must include participating securities in its calculation of basic and diluted earnings per share (“EPS”) pursuant to the two-class method, as described in FASB Statement 128, “Earnings per Share.” The Company does not issue share-based payment awards that contain nonforfeitable rights to dividends and, as a result, the adoption of FSP EITF 03-6-1 did not have a significant effect on its consolidated financial statements.

On January 1, 2009, the Company adopted FSP EITF 99-20-1, “Amendment to the Impairment Guidance of EITF Issue 99-20.” FSP EITF 99-20-1 amends the impairment guidance in EITF Issue 99-20 to achieve more consistent determination of whether an other-than temporary-impairment has occurred. The Company does not have any beneficial interest in securitized financial assets and, as a result, the adoption of FSP EITF 99-20-1 did not have a significant effect on its consolidated financial statements.

2. Fair Value Measurements

In accordance with SFAS No. 157, a fair value measurement is determined based on the assumptions that a market participant would use in pricing an asset or liability. SFAS No. 157 also established a three-tiered hierarchy that draws a distinction between market participant assumptions based on (i) observable inputs such as quoted prices in active markets (Level 1), (ii) inputs other than quoted prices in active markets that are observable either directly or indirectly (Level 2) and (iii) unobservable inputs that require the Company to use present value and other valuation techniques in the determination of fair value (Level 3).

The following table represents our financial assets and liabilities measured at fair value on a recurring basis and the basis for that measurement:

	Total Fair Value Measurement	Fair Value Measurement at March 31, 2009 Using:		
		Quoted Price in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Put warrants	\$ 1,971,058	\$ —	\$ 1,971,058	\$ —

The Company values the put warrants using the Black-Scholes model with the following assumptions:

Exercise price	\$0.078 & \$0.0858
Underlying common stock price	\$0.07
Volatility	104.0%
Contractual term	6.9 years
Risk free interest rate	2.28%
Common stock dividend rate	0%
Dilution factor	22.6%

In accordance with EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock," the Company has classified the fair value of the warrants as a liability and changes in the fair value of the warrants are recognized in the earnings of the Company as long as the warrants remain classified as a liability.

3. Accounts Receivable

Accounts receivable consists of billed and unbilled amounts under contracts in progress with governmental units, principally, the Office of the Comptroller of the Currency, the Department of State, and the Internal Revenue Service. The components of accounts receivable are as follows:

	<u>March 31, 2009</u>	<u>December 31, 2008</u>
Billed receivables	\$ 3,943,213	\$ 3,826,514
Unbilled receivables	<u>2,760,960</u>	<u>3,094,254</u>
Total accounts receivable – contracts, net	<u>\$ 6,704,173</u>	<u>\$ 6,920,768</u>

All receivables are expected to be collected within the next twelve months and are pledged to SVB as collateral for the Loan and Security Agreement with SVB. The Company's unbilled receivables are comprised of contract costs that cover the current service period and are normally billed in the following month and do not include the offset of any advances received. In general, for cost-plus and time and material contracts, invoicing of the unbilled receivables occurs when contractual obligations or milestones are met. Invoicing for firm fixed price contracts occurs on delivery and acceptance. The Company's unbilled receivables at March 31, 2009 do not contain retainage. All advance payments received, if any, are recorded as deferred revenue.

The Company establishes an allowance for doubtful accounts based upon factors surrounding the historical trends and other information of the government agencies it conducts business with. Such losses have been within management's expectations. The Company reserved \$20,733 as an allowance for doubtful accounts related to certain customers at March 31, 2009 and December 31, 2008.

4. PREPAID EXPENSES

Prepaid expenses consist of the following:

	<u>March 31, 2009</u>	<u>December 31, 2008</u>
Prepaid insurance, rent and software maintenance agreements	\$ 134,499	\$ 136,357
Contract-related prepaid expenses	473,573	618,439
Other prepaid expenses	<u>311,134</u>	<u>279,041</u>
Total prepaid expenses	<u>\$ 919,206</u>	<u>\$ 1,033,837</u>

5. PROPERTY AND EQUIPMENT

Property and equipments are as follows:

	<u>March 31, 2009</u>	<u>December 31, 2008</u>
Furniture and fixtures	\$ 109,445	\$ 109,445
Equipment	778,121	778,121
Software	532,767	528,768
Leasehold improvement	43,194	43,194
Total property and equipment	<u>1,463,527</u>	<u>1,459,528</u>
Accumulated depreciation	<u>(1,301,476)</u>	<u>(1,275,916)</u>
Property and equipment, net	<u>\$ 162,051</u>	<u>\$ 183,612</u>

Depreciation and amortization expense included in selling, general and administrative expenses in the accompanying condensed consolidated statements of operations for the three months ended March 31, 2009 and 2008 was \$25,561, and \$91,617, respectively.

6. DEFERRED FINANCING COSTS

Deferred financing costs are as follows:

	<u>March 31, 2009</u>	<u>December 31, 2008</u>
Financing costs	\$ 1,039,671	\$ —
Accumulated amortization	<u>(30,891)</u>	<u>—</u>
Net carrying amount	<u>\$ 1,008,780</u>	<u>\$ —</u>

Financing costs incurred are amortized over the life of the associated financing arrangements using the effective interest rate method. Amortization expense included in interest expenses in the accompanying condensed consolidated statements of operations for the three months ended March 31, 2009 was \$30,891. There was no amortization expense for the three months ended March 31, 2008.

For the remaining nine months ending December 31, 2009	\$ 258,237
For the years ending December 31,	
2010	358,305
2011	353,792
2012	38,446

7. INTANGIBLE ASSETS

Intangible assets are as follows:

	<u>March 31, 2009</u>	<u>December 31, 2008</u>
Contract backlog	\$ 1,810,000	\$ 1,810,000
Accumulated amortization	<u>(652,227)</u>	<u>(565,409)</u>
Net carrying amount	<u>\$ 1,157,773</u>	<u>\$ 1,244,591</u>

The Company recorded \$1.8 million of contract backlog associated with the Trinity and CTS acquisitions in 2007. These intangible assets are being amortized over a period of five years and have no residual value at the end of their useful lives. Amortization expense included in selling, general and administrative expenses in the accompanying condensed consolidated statements of operations for the three months ended March 31, 2009 and 2008 was \$86,818. The Company estimates that it will incur the following amortization expense for the future periods indicated below.

For the remaining nine months ending December 31, 2009	\$ 260,455
For the years ending December 31,	
2010	347,273
2011	347,273
2012	202,772

8. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses are as follows:

	<u>March 31, 2009</u>	<u>December 31, 2008</u>
Accounts payable	\$ 1,399,407	\$ 2,969,262
Accrued expenses	494,274	529,428
Total accounts payable and accrued expenses	<u>\$ 1,893,681</u>	<u>\$ 3,498,690</u>

9. DEBTS

At March 31, 2009 and December 31, 2008, outstanding debts consisted of the following:

	<u>March 31, 2009</u>	<u>December 31, 2008</u>
Current debts:		
Note payable – line of credit	\$ 4,019,658	\$ 5,949,983
Note payable – promissory note	—	2,000,000
Mandatorily redeemable preferred stock, current portion	50,000	—
Total current debt	<u>\$ 4,069,658</u>	<u>\$ 7,949,983</u>
Long-term debts:		
Mandatorily redeemable preferred stock	\$ 6,206,000	\$ —
Accretion of preferred stock	41,373	—
Less: unamortized discount	(1,873,296)	—
Carrying amount	4,374,077	—
Less: current portion	(50,000)	—
Mandatorily redeemable preferred stock, net of current portion	<u>\$ 4,324,077</u>	<u>\$ —</u>
Put warrants	\$ 1,971,058	\$ —
Total long-term debt, net of current portion	<u>\$ 6,295,135</u>	<u>\$ —</u>

Note Payable – Line of Credit

On March 13, 2007, the Company entered into two Loan and Security Agreements with SVB, one of which provided for a revolving credit facility of up to \$10 million and the other of which provided for a working capital line of credit of up to \$12 million. SVB and the Company have agreed that the revolving credit facility has no further force or effect. The Company continues to use the working capital line of credit to borrow funds for working capital and general corporate purposes. References to the Loan and Security Agreement in this description refer to the working capital line of credit agreement. The Loan and Security Agreement is secured by a first priority perfected security interest in any and all properties, rights and assets of the Company, wherever located, whether now owned or thereafter acquired or arising and all proceeds and products thereof as described in the Loan and Security Agreement.

Under the Loan and Security Agreement, the line of credit is due on demand and interest is payable monthly based on a floating per annum rate equal to the aggregate of the Prime Rate plus the applicable spread which ranges from 1.00% to 2.00%, as well as other fees and expenses as set forth more fully in the agreements. The Loan and Security Agreement, requires the Company to maintain certain EBITDA covenants as specified in the Loan and Security Agreement. Because the Company was not in compliance with the EBITDA covenant at June 30, 2008, the Company and SVB amended the Loan and Security Agreement to waive the covenant compliance for the periods ended June 30 and July 31, 2008 and provide for modified EBITDA covenant amounts for the remainder of 2008. The EBITDA covenant amounts for 2009 remain unchanged from the original agreement. The Company was not in compliance with the EBITDA covenant set forth in Section 6.7(b) of the Loan and Security Agreement as of the three month period ended March 31, 2009. SVB has waived such noncompliance. As of March 31, 2009, the Company had \$4.0 million outstanding, and \$0.5 million additional availability, under its working capital line of credit with SVB.

On March 18, 2009, the Company and SVB entered into a Second Loan Modification Agreement. This Second Loan Modification Agreement amended the Loan and Security Agreement to extend the maturity date to May 12, 2009 and modify the funds available under the working capital line of credit facility to not exceed \$4.5 million and the total funds available under the Loan and Security Agreement to a maximum amount of \$5.625 million. The interest rates and EBITDA covenant are consistent with the previous agreement for the remainder of the extension period. SVB and the Company are working on renewing the Loan and Security Agreement for an additional one-year period. Based on the term sheet provided to the Company by SVB, the Company believes that the interest rates and access to funding under the agreement will be similar to the extension agreement. The EBITDA covenant and other significant terms contained within the agreement are currently being negotiated by the Company and SVB.

On May 4, 2009, the Company and SVB entered into a Third Loan Modification Agreement. This Third Loan Modification Agreement amended the Loan and Security Agreement to extend the maturity date to June 12, 2009.

The Loan and Security Agreement contains events of default that include among other things, non-payment of principal, interest or fees, violation of covenants, inaccuracy of representations and warranties, cross default to certain other indebtedness, bankruptcy and insolvency events, change of control and material judgments. Upon occurrence of an event of default, SVB is entitled to, among other things, accelerate all obligations of the Company and sell the Company's assets to satisfy the Company's obligations under the Loan and Security Agreement. As of March 31, 2009, no events of default had occurred.

Note Payable – Promissory Note

On April 9, 2007, the Company issued a \$4.0 million promissory note to the former shareholders of Trinity to finance the acquisition of Trinity.

Under the terms of the promissory note, the Company was required to repay the principal plus interest at the annual rate of 7.75% of the unpaid balance pursuant to the following terms:

- (a) \$500 thousand was required to be paid within three business days of April 9, 2007;
- (b) \$1.5 million (the "Second Amount") was required to be paid on June 30, 2007; and
- (c) the remainder amount (the "Remainder Amount") of \$2.0 million was required be paid on October 31, 2008.

Effective as of October 31, 2008, the Company negotiated an amendment to the promissory note that extended the payment date of the Remainder Amount from October 31, 2008 to December 15, 2008 in exchange for a cash fee of \$40,000 plus accrued and unpaid interest based on the original terms. If the Company failed to pay the Remainder Amount by December 15, 2008, the Company was required to pay an amount equal to \$60,000 plus all accrued and unpaid interest through December 15, 2008. If the Company failed to pay the amounts owed under the promissory note by December 15, 2008, interest was to accrue, at a rate equal to 12% per annum, on such amounts. The Company did not pay the Remainder Amount prior to December 15, 2008. The failure by the Company to pay the Remainder Amount on or before December 15, 2008 did not constitute a default under the promissory note. The Company and Christian Kleszewski (the Company's Vice President (Trinity, IMS)) separately agreed that the \$1.0 million portion of the promissory note payable to Mr. Kleszewski was to be due in January 2009. The Company used a portion of the proceeds from the private placement described below to pay the note in full on February 27, 2009.

Mandatorily Redeemable Preferred Stock and Warrants

On February 27, 2009, the Company completed a private placement to a group of investors led by Hale Capital Partners, LP ("the Purchasers") for gross proceed of \$6.2 million. The Company issued 6,206 shares of Series A-1 Preferred Stock, which bear an annual dividend of 12.5%. Each share of Series A-1 Preferred Stock has an initial stated value of \$1,000 per share (the "Stated Value"). The private placement included 7-year Class A Warrants to purchase an aggregate of 79,602,604 shares of Common Stock at an exercise price of \$0.0780 per share and 7-year Class B Warrants to purchase an aggregate of 69,062,248 shares of Common Stock at an exercise price of \$0.0858 per share (collectively, the "Warrants"). We refer to the Class A Warrants, the Class B Warrants and the Series A-1 Preferred Stock collectively as the "Securities". Except for the exercise price and number of shares of Common Stock subject to the Warrants, the terms of the Class A Warrants and the Class B Warrants are substantially similar. In addition, the Class A Warrants are subject to extension for an additional seven years if the Company has not met certain milestones. The Warrants may be exercised for cash or on a cashless exercise basis. The Warrants are subject to full ratchet anti-dilution provisions and other customary anti-dilution provisions as described therein. The Warrants further provide that in the event of certain fundamental transactions or the occurrence of an event of default under the Certificate of Designations that the holder of the Warrants may cause the Company to repurchase such Warrants for the purchase price specified therein. Among the use of proceeds, \$2.1 million was used to pay off the promissory note issued in connection with our acquisition of Trinity, we paid fees and transaction costs of approximately \$1.0 million and we used the remaining \$3.1 million to pay down debt and for general working capital purposes.

Voting

The holders of Series A-1 Preferred Shares are entitled to vote together with the common stock on all matters and in the same manner. Each share of the Series A Preferred Stock shall entitle the holders to the number of votes equal to the number of shares of the common stock issuable upon exercise of all Class A Warrants held by such holder as of the record date for the vote.

Dividends

The holders of the Series A-1 Preferred Stock are entitled to receive cumulative dividends at the rate of 12.5% per annum, accruing on a daily basis and compounding monthly, with 40% of such dividends payable in cash and 60% of such dividends payable by adding such amount to the Stated Value per share of the Series A-1 Preferred Stock. The dividend shall be paid on a monthly basis to the holders of Series A-1 Preferred Stock entitled to receive such dividends.

Liquidation

Upon the occurrence of a liquidation event (including certain fundamental transactions), the holders of the Series A-1 Preferred Stock are entitled to receive prior and in preference to the payment of any amounts to the holders of any other equity securities of the Company (the "Junior Securities") (i) 125% of the Stated Value of the outstanding shares of Series A-1 Preferred Stock, (ii) all accrued but unpaid cash dividends with respect to such shares of Series A-1 Preferred Stock and the (iii) specified repurchase prices with respect to all Warrants (as defined below) held by such holders.

Redemption

The Certificate of Designations of the Series A-1 Preferred Stock provides that any shares of Series A-1 Preferred Stock outstanding as of February 9, 2012 are to be redeemed by the Company for their Stated Value plus all accrued but unpaid cash dividends on such shares (the "Redemption Price"). In addition, on the last day of each calendar month beginning February 2009 through and including February 2010, the Company is required to redeem the number of shares of Series A-1 Preferred Stock obtained by dividing 100% of all Excess Cash Flow (as defined in the Certificate of Designations) with respect to such month by the Redemption Price applicable to the shares to be redeemed. Further, on the last day of each month beginning March 2010 through and including January 2012, the Company shall redeem the number of shares of Series A-1 Preferred Stock obtained by dividing the sum of \$50,000 plus 50% of the Excess Cash Flow with respect to such month by the Redemption Price applicable to the shares to be redeemed. At anytime prior to February 9, 2012, the Company may redeem shares of Series A-1 Preferred Stock for 125% of the Stated Value of such shares plus all accrued but unpaid cash dividends for such shares. If at anytime a Purchaser realizes cash proceeds with respect to the Securities or common stock received upon exercise of the Warrants equal to or greater than the aggregate amount paid by the Purchaser for the Securities plus 200% of such amount then the Company has the option to repurchase all outstanding shares of Series A-1 Preferred Stock held by that Purchaser for no additional consideration.

Covenants

The Preferred Stock Purchase Agreement and the Certificate of Designations also contain certain affirmative and negative covenants. The negative covenants require the prior approval of Hale Capital, for so long as (i) an aggregate of not less than 15% of the shares of Series A-1 Preferred Stock purchased on February 27, 2009 are outstanding, (ii) Warrants to purchase an aggregate of not less than 20% of the shares issuable pursuant to the Warrants on February 27, 2009 are outstanding or (iii) the Purchasers, in the aggregate, own not less than 15% of the common stock issuable upon exercise of all Warrants on February 27, 2009 (we refer to (i), (ii) and (iii) as the "Ownership Threshold") in order for the Company to take certain actions, including, among others, (i) amending the Company's Articles of Incorporation or other charter documents, (ii) liquidating, dissolving or winding-up the Company, (iii) merging with, consolidating with or acquiring or being acquired by, or selling all or substantially all of its assets to, any person, (iv) selling, licensing or transferring any capital stock or assets with a value, individually or in the aggregate, of \$100,000 or more, (v) undergoing certain fundamental transactions, (vi) certain issuances of capital stock, (vii) certain redemptions or dividend payments, (viii) the creation, incurrence or assumption of certain types of indebtedness or liens, (ix) increasing or decreasing the size of the Company's Board of Directors and (x) appointing, hiring, suspending or terminating the employment or materially modifying the compensation of any executive officer.

The Company accounts for its preferred stock based upon the guidance enumerated in SFAS No. 150. The Series A-1 Preferred Stock is mandatorily redeemable on February 9, 2012 and therefore is classified as a liability instrument on the date of issuance. The Warrants issued in connection with the Series A-1 Preferred Stock provide that the holders of the Warrants may cause the Company to repurchase such Warrants for the purchase price in the event of certain fundamental transactions or the occurrence of an event of default. The Company evaluated the Warrants pursuant to EITF No. 00-19 and determined that the Warrants should be classified as liabilities because they contain a provision that could require cash settlement and that event is outside the control of the Company. The warrants should be measured at fair value, with changes in fair value reported in earnings as long as the warrants remain classified as a liability. The initial proceeds allocated to preferred shares and warrants are \$4,299,274 and \$1,906,726, respectively

The Company is amortizing the warrant discount using the effective interest rate method over the three year term of the Series A-1 Preferred Stock. Although the stated interest rate of the Series A-1 Preferred Stock is 12.5%, as a result of the discount recorded for the warrants, the effective interest rate is 26.79%. The Company also incurred approximately \$1,040,000 of costs in relation to this transaction, which were recorded as deferred financing costs to be amortized over the term of the Series A-1 Preferred Stock.

The Company calculated the fair value of the warrants at the date of issuance using the Black-Scholes option pricing model. The change in fair value of the Warrants issued in connection with the Series A-1 Preferred stock from the date of issuance to March 31, 2009, was an increase of approximately \$43 thousand from \$1.9 million as of February 27, 2009 to \$2.0 million as of March 31, 2009. This change of fair value of the Warrants was reflected as a component of other expense within the statement of operations for the three months ended March 31, 2009.

10. INCOME TAXES

The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes." Under SFAS No.109, the Company recognizes deferred income taxes for all temporary differences between the financial statement basis and the tax basis of assets and liabilities at currently enacted income tax rates.

Deferred income taxes are recognized for the tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each year end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable earnings. Valuation allowances are established when necessary to reduce deferred tax assets to the amount more likely than not to be realized.

The Company adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109" ("FIN No. 48"), on January 1, 2007. FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109 and prescribes a recognition threshold and measurement process for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The Company concluded that there are no significant uncertain tax positions requiring recognition in the financial statements based on an evaluation performed for the tax years ended December 31, 2005, 2006, 2007, 2008 and 2009, the tax years which remain subject to examination by major tax jurisdictions as of March 31, 2009.

The Company may from time to time be assessed interest or penalties by major tax jurisdictions, although any such assessments historically have been immaterial to the Company's financial results. As of March 31, 2009, the Company had recorded immaterial interest and penalties associated with the filing of the 2006 and 2007 tax returns and no unrecognized tax benefits that would have an effect on the effective tax rate. The Company elected to continue to report interest and penalties as income tax expense.

The Company recorded a current income tax benefit as of March 31, 2009 of \$74 thousand. The Company expects to utilize this benefit to off-set taxable income from the remaining nine months ending December 31, 2009.

11. NET LOSS PER COMMON SHARE

Net loss per common share is computed by dividing net loss by the weighted average number of common shares outstanding during the reported period. Shares issued during the period and shares reacquired during the period are weighted for the portion of the period in which the shares were outstanding. Diluted net loss per common share has been computed in a manner consistent with that of basic net loss per common share giving the loss position of the Company. The following table reflects the computation of the Company's basic and diluted net loss per common share for the three months ended March 31, 2009 and 2008.

	Three Months Ended	
	March 31, 2009	March 31, 2008
Basic and diluted net loss per common share:		
Net loss	\$ (627,679)	\$ (237,488)
Dividends on preferred stock	78,870	45,000
Net loss attributable to common stockholders	<u>\$ (706,549)</u>	<u>\$ (282,488)</u>
Weighted average common shares outstanding – basic	26,413,111	19,148,153
Treasury effect of stock options	—	—
Total weighted average common shares outstanding – diluted	<u>26,413,111</u>	<u>19,148,153</u>
Basic and diluted net loss per common share	\$ (0.03)	\$ (0.01)

Common stock equivalents of 54,821,539 and 4,451,043 were not included in the computation of diluted net loss per common share for the three months ended March 31, 2009 and 2008, respectively, as the inclusion of these common stock equivalents would be anti-dilutive due to the Company's net loss position and including such shares would reduce the net loss per common share in those periods.

12. STOCK INCENTIVE PLAN

On August 3, 2006, the Board of Directors and stockholders approved the 2006 Stock Incentive Plan (the "Plan"). A total of 2,500,000 shares of common stock are were initially reserved for issuance under the Plan. At March 31, 2009, 3,758,799 shares of common stock were reserved for issuance under the Plan. The shares of common stock reserved for issuance under the Plan are in addition to approximately 1,057,667 shares of common stock which have been reserved for issuance related to standalone stock options that were granted by the Company to employees and directors on December 15, 2005 and May 15, 2006. As of March 31, 2009, 2,925,000 shares of restricted common stock and options to purchase 507,000 shares of common stock have been issued under the Plan and options to purchase 2,622,000 shares of common stock have been granted outside of the Plan. Individual awards under the Plan may take the form of incentive stock options and nonqualified stock options. To date, only nonqualified stock options have been granted under the Plan. These awards generally vest over three years of continuous service.

The Compensation Committee administers the Plan, selects the individuals who will receive awards and establishes the terms and conditions of those awards. Shares of common stock subject to awards that have expired, terminated, or been canceled or forfeited are available for issuance or use in connection with future awards.

Stock Options

The following table summarizes the Company's stock option activity.

	Number of Options	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted Average Remaining Contractual Life (in years)
Outstanding at December 31, 2008	1,578,000	\$ 0.29	\$ —	7.6
Granted	—	—		
Exercised	—	—		
Canceled	(15,000)	0.23		
Outstanding at March 31, 2009	1,563,000	\$ 0.29	\$ —	7.4
Exercisable at December 31, 2008	1,081,667	\$ 0.30		7.3
Exercisable at March 31, 2009	1,080,000	\$ 0.30	\$ —	7.0

Aggregate intrinsic value is calculated by multiplying the excess of the closing market price of \$0.07 at March 31, 2009 over the exercise price by the number of "in-the money" options outstanding.

Share-based compensation expense included in selling, general and administrative expenses in the accompanying condensed consolidated statements of operations for the three months ended March 31, 2009 and 2008 was \$83 thousand and \$80 thousand, respectively.

The Company did not grant any stock options during the three months ended March 31, 2009 and 2008. The fair value of the options granted during fiscal 2008 was \$20 thousand and is included as part of additional paid-in capital as vested. As of March 31, 2009, the Company had \$139 thousand of total unrecognized option compensation costs, which will be recognized over a weighted average period of 1.1 years.

Restricted Common Stock

On May 3, 2007, the Board of Directors of the Company granted restricted shares of common stock, par value \$0.01 per share, to certain individuals. The restricted shares will vest on January 2, 2012 and have no interim vesting periods. On October 21, 2008, the Board of Directors of the Company granted restricted shares of common stock, par value \$0.01 per share, to certain individuals. The restricted shares will vest on January 2, 2013 and have no interim vesting periods.

The restricted shares were issued from the Plan with the intent of providing a longer-term employment retention mechanism to key management and board members.

The following table summarizes the Company's restricted common stock activity.

	<u>Number of Restricted Common Stock</u>	<u>Aggregate Fair Value</u>	<u>Weighted Average Vesting Periods (in years)</u>	<u>Weighted Average Remaining Vesting Periods (in years)</u>
Outstanding at December 31, 2008	2,925,000	\$ 1,425,000	4.4	3.3
Granted	—	—	—	—
Outstanding at March 31, 2009	<u>2,925,000</u>	<u>\$ 1,425,000</u>	<u>4.4</u>	<u>3.0</u>

Share-based compensation expense for the restricted stock was included in selling, general and administrative expenses in the accompanying condensed consolidated statements of operations. The compensation expense recognized for the three months ended March 31, 2009 and 2008 was \$78 thousand and \$60 thousand, respectively.

The total fair value of the restricted stock granted in fiscal 2008 and 2007 was \$0.3 million and \$1.1 million, respectively, calculated by multiplying the number of shares of restricted common stock granted and the closing market price of \$0.20 on October 21, 2008 and \$0.80 on May 3, 2007, respectively, and will be included as part of additional paid-in capital over the vesting period. As of March 31, 2009, the unrecognized compensation costs related to the remaining nonvested shares of restricted stock was \$0.9 million, which will be recognized over a weighted average period of 3.0 years.

13. STOCKHOLDERS EQUITY

Series A Preferred Stock

On July 25, 2007, the Company completed a private placement led by members of the Company's senior management and Board of Directors for gross proceeds of \$1.8 million. The Company issued 1,800 shares of convertible preferred stock ("Series A Preferred Stock") with par value of \$0.01 per share, which bore an annual dividend of 10% and were convertible into 1.5 million shares of the Company's common stock at an average of \$1.20 per common share. The private placement included 5-year warrants to purchase approximately 149,400 shares of common stock at \$1.20 per share. Proceeds from this offering were used for general working capital and acquisition financing. The investors included certain of the officers and directors of the Company.

In connection with the private placement on February 27, 2009, the Company exchanged 1,700 shares of the Company's outstanding Series A Preferred Stock for an aggregate of approximately 21.8 million shares of common stock and repurchased 100 shares of Series A Preferred Stock for a cash payment to certain shareholders of an aggregate of approximately \$107,000, excluding approximately \$4,000 of dividends.

Warrants

In connection with the Series A Preferred Stock issuance on July 25, 2007, the Company issued the purchasers of the Series A Preferred Stock 5-year warrants to purchase an aggregate of approximately 149,400 shares of common stock at \$1.20 per share. The Company also issued warrants to the placement agent to purchase 83,333 common shares of the Company at \$1.20 per share. The warrants were classified as equity in accordance with EITF No. 00-19 primarily because such warrants do not provide for net cash settlement. Warrants issued were valued at \$139 thousand, using the Black Scholes model, and recorded as part of additional paid-in capital using the Black Scholes model.

14. CONTRACT STATUS

Provisional Indirect Cost Rates

Billings under cost-plus government contracts are calculated using provisional rates which permit recovery of indirect costs. These rates are subject to audit on an annual basis by governmental audit agencies. The cost audits will result in the negotiation and determination of the final indirect cost rates which the Company may use for the period(s) audited. The final rates, if different from the provisional, may create an additional receivable or liability.

As of March 31, 2009, the Company has had no final settlements on indirect rates. The Company periodically reviews its cost estimates and experience rates and adjustments, if needed, are made and reflected in the period in which the estimates are revised. In the opinion of management, redetermination of any cost-based contracts for the open years will not have any material effect on the Company's financial position or results of operations.

The Company has authorized but uncompleted contracts on which work is in progress at March 31, 2009 approximately, as follows:

Total contract prices of initial contract awards, including exercised options and approved change orders (modifications)	\$ 112,355,337
Completed to date	<u>99,012,131</u>
Authorized backlog	<u>\$ 13,343,206</u>

The foregoing contracts contain unfunded and unexercised options not reflected in the above amounts of approximately \$54,660,000.

As of March 31, 2009, three of the Company's existing contracts are subject to renegotiation during the remainder of 2009.

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

This quarterly report contains forward-looking statements. These statements relate to future events or our future financial performance. In some cases, readers can identify forward-looking statements by terminology such as "may," "will," "should," "could," "forecasts," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "potential," "see," "target," "projects," "position," or "continue" or the negative of such terms and other comparable terminology. These statements reflect our current expectations, estimates, and projections. These statements are not guarantees of future performance and involve risks, uncertainties, and assumptions that are difficult to predict. Actual events or results may differ materially from what is expressed or forecasted in these forward-looking statements. We disclaim any intention or obligation to update any forward-looking statement.

OVERVIEW

Paradigm Holdings, Inc. (the "Company" or "Paradigm") provides information technology ("IT"), information assurance, and business continuity solutions, primarily to U.S. Federal Government customers. Headquartered in Rockville, Maryland, the Company was founded based upon strong commitment to high standards of performance, integrity, customer satisfaction, and employee development.

With an established core of experienced executives, the Company has grown from six employees in 1996 to 182 personnel (full time, part time, and consultants) at March 31, 2009. The 2009 annual run-rate of revenue is approximately \$31 million, based on revenue for the three months ended March 31, 2009. The results for interim periods are not necessarily indicative of the results to be expected for the fiscal year.

As of March 31, 2009, Paradigm had three wholly-owned subsidiaries, Paradigm Solutions Corp. ("PSC"), which was incorporated in 1996 to deliver IT services to federal agencies, Trinity IMS, Inc. ("Trinity"), which was acquired on April 9, 2007 to deliver IT solutions into the national security marketplace and Caldwell Technology Solutions, LLC ("CTS") which was acquired on July 2, 2007 to provide advanced IT solutions in support of National Security programs within the Intelligence Community.

We derive substantially all of our revenue from fees for IT solutions and services. We generate these fees from contracts with various payment arrangements, including time and materials contracts, fixed-price contracts and cost-plus contracts. We typically issue invoices monthly to manage outstanding accounts receivable balances. We recognize revenue on time and materials contracts as the services are provided. For the three months ended March 31, 2009, our business was comprised of 57% fixed price and 43% time and material contracts.

For the three months ended March 31, 2009, contracts with the federal government and contracts with prime contractors of the federal government accounted for 100% of our revenue. During that same period, our three largest clients, all agencies within the federal government, generated approximately 73% of our revenue. In most of these engagements, we retain full responsibility for the end-client relationship and direct and manage the activities of our contract staff.

Our most significant expense is direct costs, which consist primarily of direct labor, subcontractors, materials, equipment, travel and an allocation of indirect costs including fringe benefits. The number of subcontract and consulting employees assigned to a project will vary according to the size, complexity, duration and demands of the project.

Selling, general and administrative expenses consist primarily of costs associated with executive management, finance and administrative groups, human resources, marketing and business development resources, employee training, occupancy costs, research and development expenses, depreciation and amortization, travel, and all other corporate costs.

Other income and expense consists primarily of interest income earned on cash and cash equivalents and interest payable on our revolving credit facility.

CRITICAL ACCOUNTING POLICIES

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses the condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of these condensed consolidated financial statements requires management to make estimates and judgments that affect the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, management evaluates its estimates including those related to contingent liabilities, revenue recognition, and other intangible assets. Management bases its estimates on historical experience and on various other factors that are believed to be reasonable at the time the estimates are made. Actual results may differ from these estimates under different assumptions or conditions.

The following critical accounting policies require management's judgment and estimation, where such estimates have a material effect on the condensed consolidated financial statements:

- accounting for revenue recognition
- accounting for cost of revenue
- accounting for goodwill and intangible assets
- accounting for impairment of long-lived assets
- accounting for share-based compensation
- accounting for valuation of warrants
- accounting for income taxes
- accounting for segment reporting

For a description of these critical accounting policies except for the accounting for valuation of warrants, refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Paradigm's Annual Report on Form 10-K for the fiscal year ended December 31, 2008.

Valuation of Warrants

The Company accounts for the issuance of common stock purchase warrants in accordance with the provisions of EITF 00-19. The Class A Warrants and Class B Warrants issued in connection with the sale of the Company's Series A-1 Senior Preferred Stock, par value \$0.01 per share (the "Series A-1 Preferred Stock"), contain a provision that could require cash settlement and that event is outside the control of the Company, and therefore are classified as a liability as of March 31, 2009. The Company assesses classification of put warrants at each reporting date to determine whether a change in classification is required. The Company values put warrants using the Black-Scholes valuation model. Put warrants are valued upon issuance, and re-valued at each financial statement reporting date. Any change in value is charged to other income or expense during the period.

RECENT ACCOUNTING PRONOUNCEMENTS

New accounting pronouncements that have a current or future potential impact on our consolidated financial statements are as follows:

Recent Accounting Pronouncements – Not Yet Adopted

STAFF POSITION NO. 157-4

DETERMINING FAIR VALUE WHEN THE VOLUME AND LEVEL OF ACTIVITY FOR THE ASSET OR LIABILITY HAVE SIGNIFICANTLY DECREASED AND IDENTIFYING TRANSACTIONS THAT ARE NOT ORDERLY

In April 2009, the Financial Accounting Standards Board (“FASB”) issued a FASB Staff Position (“FSP”) No. 157-4 (“FSP No. 157-4”), “Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly.”

SCOPE OF THIS STATEMENT

FSP No. 157-4 provides additional guidance for estimating fair value in accordance with SFAS No. 157, “Fair Value Measurements” when the volume and level of activity for the asset or liability have significantly decreased. This FSP re-emphasizes that regardless of market conditions the fair value measurement is an exit price concept as defined in SFAS No. 157. This FSP clarifies and includes additional factors to consider in determining whether there has been a significant decrease in market activity for an asset or liability and provides additional clarification on estimating fair value when the market activity for an asset or liability has declined significantly. The scope of this FSP does not include assets and liabilities measured under level 1 inputs. The Company will adopt FSP No. 157-4 effective June 30, 2009. The adoption of FSP No. 157-4 is not expected to have a material impact on the Company’s statements of operations, financial position or cash flows.

STAFF POSITION NO. 107-1 AND APB 28-1

INTERIM DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS.” THIS FSP WHICH AMENDS SFAS NO. 107, “DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

In April 2009, the FASB issued FSP No. 107-1 and APB 28-1, “Interim Disclosures about Fair Value of Financial Instruments.” This FSP amends SFAS No. 107, “Disclosures about Fair Value of Financial Instruments.”

SCOPE OF THIS STATEMENT

FSP No. 107-1 and APB 28-1 require publicly-traded companies, as defined in APB Opinion No. 28, “Interim Financial Reporting,” to provide disclosures on the fair value of financial instruments in interim financial statements. The Company will adopt FSP No. 107-1 and APB 28-1 effective June 30, 2009. The adoption of FSP No. 107-1 and APB 28-1 is not expected to have a material impact on the Company’s statements of operations, financial position or cash flows.

STAFF POSITION NO. 115-2 AND NO. 124-2

RECOGNITION AND PRESENTATION OF OTHER-THAN-TEMPORARY IMPAIRMENTS

In April 2009, the FASB issued FSP No. 115-2 and No. 124-2, “Recognition and Presentation of Other-Than-Temporary Impairments.”

SCOPE OF THIS STATEMENT

FSP No. 115-2 and No. 124-2 changes the method for determining whether an other-than-temporary impairment exists for debt securities and the amount of the impairment to be recorded in earnings. The Company will adopt FSP No. 115-2 and No. 124-2 effective June 30, 2009. The adoption of FSP No. 115-2 and No. 124-2 is not expected to have a material impact on the Company’s statements of operations, financial position or cash flows.

Recent Accounting Pronouncements – Adopted

On January 1, 2009, the Company adopted SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133.” The statement modifies and expands the disclosure requirements for derivative instruments and hedging activities. SFAS No. 161 requires that objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation and requires quantitative disclosures about fair value amounts and gains and losses on derivative instruments. It also requires disclosures about credit-related contingent features in derivative agreements. The adoption of SFAS No. 161 did not have a material impact on the Company’s statements of operations, financial position or cash flows.

On January 1, 2009, the Company adopted SFAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements.” The statement establishes the accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. The adoption of SFAS No. 160 did not have a material impact on the Company’s statements of operations, financial position or cash flows.

On January 1, 2009, the Company adopted SFAS No. 141 (revised 2007), “Business Combinations.” The statement establishes principles and requirements for how the acquirer recognizes and measures the identifiable assets acquired, the goodwill acquired, the liabilities assumed and any noncontrolling interest in the acquiree and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The adoption of SFAS No. 141 (revised 2007) did not have a material impact on the Company’s statements of operations, financial position or cash flows. The Company will apply SFAS No. 141 (revised 2007) to its future acquisitions, if any.

On January 1, 2009, the Company adopted FASB Staff Position (“FSP”) No. 157-2 (“FSP No. 157-2”), “Effective Date of FASB Statement No. 157.” FSP No. 157-2 applies to nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in an entity’s financial statements on a recurring basis (at least annually) and defers the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008 for items within the scope of this FSP. The adoption of FSP No. 157-2 did not have a material impact on the Company’s statements of operations, financial position or cash flows.

On January 1, 2009, the Company adopted FSP No. 142-3 (“FSP No. 142-3”), “Determination of the useful life of intangible assets.” FSP No. 142-3 amends the factors that should be considered in developing the renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, “Goodwill and Other Intangible Assets.” FSP No. 142-3 also requires additional disclosures on information that can be used to assess the extent to which future cash flows associated with intangible assets are affected by an entity’s intent or ability to renew or extend such arrangements and on associated accounting policies. The adoption of FSP No. 142-3 may impact the Company in the future if the Company acquires intellectual property or other assets.

On January 1, 2009, the Company adopted FSP APB 14-1 (“FSP APB 14-1”), “Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement).” FSP APB 14-1 requires issuers of convertible debt to account separately for the liability and equity components of these instruments if they have stated terms permitting cash settlement upon conversion. This practice marks a significant change from the current accounting practice for convertible debt instruments in the scope of the FSP. Current practice does not require separation of the liability and equity components of such instruments. Separately accounting for these instruments’ liability and equity components results in the recording of more interest cost over the life of the convertible debt instrument, because of an initial debt discount. The adoption of FSP APB 14-1 did not have a material impact on the Company’s statements of operations, financial position or cash flows.

On January 1, 2009, the Company adopted FSP EITF 03-6-1 (“FSP EITF 03-6-1”), “Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities.” FSP EITF 03-6-1 clarifies that all outstanding unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents, whether paid or unpaid, are participating securities. An entity must include participating securities in its calculation of basic and diluted earnings per share (“EPS”) pursuant to the two-class method, as described in FASB Statement 128, “Earnings per Share.” The Company does not issue share-based payment awards that contain nonforfeitable rights to dividends and, as a result, the adoption of FSP EITF 03-6-1 did not have a significant effect on its consolidated financial statements.

On January 1, 2009, the Company adopted FSP EITF 99-20-1 (“FSP EITF 99-20-1”), “Amendment to the Impairment Guidance of EITF Issue 99-20.” FSP EITF 99-20-1 amends the impairment guidance in EITF Issue 99-20 to achieves more consistent determination of whether an other-than temporary-impairment has occurred. The Company does not have any beneficial interest in securitized financial assets and, as a result, the adoption of FSP EITF 99-20-1 did not have a significant effect on its consolidated financial statements

RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with Paradigm’s condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q and with Paradigm’s consolidated financial statements and the information under the heading “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” which are included in Paradigm’s Annual Report on Form 10-K for the fiscal year ended December 31, 2008.

The following table sets forth certain items from our condensed consolidated statements of operations for the periods indicated.

(Dollars in thousands)	Three Months Ended March 31,			
	2009	2008	2009	2008
Revenue	\$ 7,708	10,797	100.0%	100.0%
Cost of Revenue	6,187	8,694	80.3	80.5
Gross Margin	1,521	2,103	19.7	19.5
Selling, General & Administrative	1,830	2,157	23.7	20.0
Loss from operations	(309)	(54)	(4.0)	(0.5)
Other expense	(393)	(265)	(5.1)	(2.5)
Benefit for income taxes	(74)	(82)	(1.0)	(0.8)
Net loss	\$ (628)	(237)	(8.1)%	(2.2)%

The table below sets forth, for the periods indicated the service mix in revenue with related percentages of total contract revenue.

(Dollars in thousands)	Three Months Ended March 31,			
	2009	2008	2009	2008
Federal Service Contracts	\$ 5,579	\$ 7,047	72.4%	65.3%
Federal Repair & Maintenance Contracts	2,129	3,750	27.6	34.7
Total Revenue	\$ 7,708	\$ 10,797	100.0%	100.0%

The Company's revenues and operating results may be subject to significant variation from quarter to quarter depending on a number of factors, including the progress of contracts, revenues earned on contracts, the number of billable days in a quarter, the timing of the pass-through of other direct costs, the commencement and completion of contracts during any particular quarter, the schedule of the government agencies for awarding contracts, the term of each contract that has been awarded and general economic conditions. Because a significant portion of total expenses, such as personnel and facilities costs, are fixed in the short term, successful contract performance and variation in the volume of activity as well as in the number of contracts commenced or completed during any quarter may cause significant variations in operating results from quarter to quarter.

The Federal Government's fiscal year ends September 30. If a budget for the next fiscal year has not been approved by that date, the Company's clients may have to suspend engagements that are in progress until a budget has been approved. Such suspensions may cause the Company to realize lower revenues in the fourth quarter of the year. Further, a change in presidential administrations and in senior government officials may negatively affect the rate at which the Federal Government purchases technology.

As a result of the factors above, period-to-period comparisons of Paradigm's revenues and operating results may not be meaningful. Readers should not rely on these comparisons as indicators of future performance as no assurances can be given that quarterly results will not fluctuate, causing a possible material adverse effect on Paradigm's operating results and financial condition.

COMPARISON OF THE THREE MONTHS ENDED MARCH 31, 2009 AND 2008

Revenue. For the three months ended March 31, 2009, revenue decreased 28.6% to \$7.7 million from \$10.8 million for the same period in 2008. The decrease in revenue is attributable to the completion of one of our federal service contracts during the second quarter of 2008 and a decrease in our federal repair and maintenance contracts business of \$1.6 million. The decrease in repair and maintenance business is attributable to a reduction in revenue on one federal contract due to a reduction in scope. We expect our current lower revenue run-rate to be reflective of near-term anticipated results

Cost of Revenue. Cost of revenue includes direct labor, materials, subcontractors and an allocation for indirect costs. Generally, changes in cost of revenue correlate to fluctuations in revenue as resources are consumed in the production of that revenue. For the three months ended March 31, 2009, cost of revenue decreased 28.8% to \$6.2 million from \$8.7 million for the same period in 2008. The decrease in cost of revenue was primarily attributable to the corresponding decrease in revenue. As a percentage of revenue, cost of revenue was 80.3% for the three months ended March 31, 2009 as compared to 80.5% for the same period in 2008. The decrease in cost as a percentage of revenue was primarily due to better contract management and better profitability on our existing contract mix.

Gross Margin. For the three months ended March 31, 2009, gross margin decreased 27.7% to \$1.5 million from \$2.1 million for the same period in 2008. The decrease in gross margin is primarily attributable to the decrease in revenue. Gross margin as a percentage of revenue increased to 19.7% for the three months ended March 31, 2009 from 19.5% for the same period in 2008. Gross margin as a percentage of revenue increased due to higher gross margin on our time and material contracts. Gross margin as a percentage of service contracts revenue increased to 22.6% from 22.3% for the same period in 2008. The increase in services gross margin is due to higher gross margin on our time and material contracts. Gross margin as a percentage of our maintenance contracts decreased to 12.2% from 14.2% for the same period in 2008. The decrease in maintenance gross margin is directly attributable to the decrease in revenue.

Selling, General & Administrative. For the three months ended March 31, 2009, selling, general & administrative (“SG&A”) expenses decreased 15.2% to \$1.8 million from \$2.2 million for the same period in 2008. As a percentage of revenue, SG&A expenses increased to 23.7% for the three months ended March 31, 2009 from 20.0% for the same period in 2008. The decrease in SG&A expense is attributable to reductions in SG&A expense because of lower revenue. Management will continue monitoring SG&A expenses in 2009 to balance the impact resulting from decreased revenues.

Other Expense. For the three months ended March 31, 2009, other expense increased 48.2% to \$393 thousand from \$265 thousand for the same period in 2008. As a percentage of revenue, other expense increased to 5.1% for the three months ended March 31, 2009 from 2.5% for the same period in 2008. The increase in other expense was primarily attributable to interest expense recorded on the mandatorily redeemable preferred stock and warrants issued on February 27, 2009 via a private placement discussed below.

Income Taxes. For the three months ended March 31, 2009, income taxes decreased to an income tax benefit of \$74 thousand from \$82 thousand for the same period in 2008. The Company’s tax provision for the three months ended March 31, 2009 and 2008 represents an estimated annual effective tax rate, excluding discrete items, of 10.6% and 34.0%, respectively. The decrease in estimated annual effective tax rate is due to the interest expense on the mandatorily redeemable preferred stock and change in fair value of warrants which are not deductible under applicable tax laws.

Net Loss. For the three months ended March 31, 2009, net loss increased to \$628 thousand from \$237 thousand for the same period in 2008. The net loss was due to lower revenue and higher interest expenses as discussed above.

LIQUIDITY AND CAPITAL RESOURCES

Our primary liquidity needs are financing our cost of operations, capital expenditures, servicing our debt and paying dividends and redemption payments on our preferred stock. Our sources of liquidity are existing cash, cash generated from operations, and cash available from borrowings under our revolving credit facility and the cash realized from the private placement in February 2009. We have historically financed our operations through our existing cash, cash generated from operations and cash available from borrowings under our revolving credit facility. Based upon the current level of operations, we believe that cash flow from operations, together with borrowings available from our credit facility with SVB and the combination of in-process cost reductions will be adequate to meet future liquidity needs for the next twelve months.

For the three months ended March 31, 2009, the Company used \$52 thousand in cash and cash equivalents versus \$20 thousand cash generated for the same period in 2008.

Net cash used in operating activities was \$1.7 million for the three months ended March 31, 2009 compared to \$1.4 million for the same period in 2008. Net cash used in operating activities decreased due to the decrease in accounts receivable and accounts payable and accrued expenses. As of March 31, 2009, the Company had \$0 cash on hand.

Net loss was \$628 thousand for the three months ended March 31, 2009 compared to \$237 thousand for the same period in 2008. The increase in net loss was primarily due to lower revenue and higher interest expense as discussed above.

Accounts receivable decreased by \$0.2 million for the three months ended March 31, 2009 compared to an increase of \$0.8 million for the same period in 2008. The decrease in the accounts receivable balance for 2009 is attributable to lower revenue and more focused billings and collection efforts.

Accounts payable and accrued expenses decreased by \$1.7 million for the three months ended March 31, 2009 compared to \$0.4 million for the same period in 2008. The decrease in accounts payable for the three months ended March 31, 2009 is primarily reflective of decreased cost of revenue and the payment of certain payables with a portion of the proceeds from the private placement on February 27, 2009.

Net cash used in investing activities was \$4 thousand for the three months ended March 31, 2009 compared to \$0.1 million for the same period in 2008. Cash used in investing activities in 2009 was primarily for purchases of property and equipment.

Net cash provided by financing activities was \$1.7 million for the three months ended March 31, 2009 compared to \$1.5 million for the same period in 2008. The increase in net cash provided by financing activities is due to proceeds from the private placement completed on February 27, 2009 which were partially offset by payments made to pay down the Company's line of credit with SVB and to pay off the promissory note issued in connection with the Company's acquisition of Trinity.

Private Placement

On February 27, 2009, the Company completed the sale, in a private placement transaction, of 6,206 shares of Series A-1 Senior Preferred Stock (the "Series A-1 Preferred Stock"), Class A Warrants to purchase up to an aggregate of approximately 79.6 million shares of common stock with an exercise price equal to \$0.0780 per share (the "Class A Warrants") and Class B Warrants to purchase up to an aggregate of approximately 69.1 million shares of common stock at an exercise price of \$0.0858 per share (the "Class B Warrants" and together with the Class A Warrants and the Series A-1 Preferred Stock, the "Securities") to a group of investors, led by Hale Capital (the "Purchasers"). The Series A-1 Preferred Stock bears an annual dividend of 12.5%. Each share of Series A-1 Preferred Stock has an initial stated value of \$1,000 per share (the "Stated Value"). Paradigm received gross proceeds of approximately \$6.2 million from the private placement. Among the use of proceeds, \$2.1 million was used to pay off the promissory note issued in connection with the Company's acquisition of Trinity, the Company paid fees and transaction costs of approximately \$1.0 million and the remaining \$3.1 million was used to pay down debt and for general working capital purposes.

The annual dividend on the Series A-1 Preferred Stock accrues on a daily basis and compounds monthly, with 40% of such dividend payable in cash and 60% of such dividend payable by adding such amount to the Stated Value per share of the Series A-1 Preferred Stock. The Company is generally required to make cash dividend payments ranging from \$26,000 to \$29,000 a month.

Any shares of Series A-1 Preferred Stock outstanding as of February 9, 2012 are to be redeemed by the Company for their Stated Value plus all accrued but unpaid cash dividends on such shares (the "Redemption Price"). In addition, on the last day of each calendar month beginning February 2009 through and including February 2010, the Company is required to redeem the number of shares of Series A-1 Preferred Stock obtained by dividing 100% of all Excess Cash Flow (as defined in the Certificate of Designations of Series A-1 Senior Preferred Stock (the "Certificate of Designations")) with respect to such month by the Redemption Price applicable to the shares to be redeemed. Further, on the last day of each month beginning March 2010 through and including January 2012, the Company shall redeem the number of shares of Series A-1 Preferred Stock obtained by dividing the sum of \$50,000 plus 50% of the Excess Cash Flow with respect to such month by the Redemption Price applicable to the shares to be redeemed. At anytime prior to February 9, 2012, the Company may redeem shares of Series A-1 Preferred Stock for 125% of the Stated Value of such shares plus all accrued but unpaid cash dividends for such shares. If at anytime a Purchaser realizes cash proceeds with respect to the Securities or common stock received upon exercise of the Class A Warrants and Class B Warrants (together, the "Warrants") equal to or greater than the aggregate amount paid by the Purchaser for the Securities plus 200% of such amount then the Company has the option to repurchase all outstanding shares of Series A-1 Preferred Stock held by that Purchaser for no additional consideration.

For so long as (i) an aggregate of not less than 15% of the shares of Series A-1 Preferred Stock purchased on February 27, 2009 are outstanding, (ii) Warrants to purchase an aggregate of not less than 20% of the shares issuable pursuant to the Warrants on February 27, 2009 are outstanding or (iii) the Purchasers, in the aggregate, own not less than 15% of the common stock issuable upon exercise of all Warrants on February 27, 2009 (we refer to (i), (ii) and (iii) as the "Ownership Threshold"), the Preferred Stock Purchase Agreement between the Company and the Purchasers (the "Preferred Stock Purchase Agreement") limits the Company's ability to offer or sell certain evidences of indebtedness or equity or equity equivalent securities (other than certain excluded securities and permitted issuances) without the prior consent of Hale Capital. Other than with respect to the issuance of certain excluded securities by the Company, the Preferred Stock Purchase Agreement further grants the Purchasers a right of first refusal to purchase certain evidences of indebtedness, equity and equity equivalent securities sold by the Company. The Company is further required to use a portion of the proceeds it receives from a subsequent placement of its securities to repurchase shares of Series A-1 Preferred Stock, Warrants and/or shares of common stock from the Purchasers.

The Preferred Stock Purchase Agreement and the Certificate of Designations also contain certain affirmative and negative covenants. The negative covenants require the prior approval of Hale Capital, for so long as the Ownership Threshold is met, in order for the Company to take certain actions, including, among others, (i) amending the Company's Articles of Incorporation or other charter documents, (ii) liquidating, dissolving or winding-up the Company, (iii) merging with, consolidating with or acquiring or being acquired by, or selling all or substantially all of its assets to, any person, (iv) selling, licensing or transferring any capital stock or assets with a value, individually or in the aggregate, of \$100,000 or more, (v) undergoing certain fundamental transactions, (vi) certain issuances of capital stock, (vii) certain redemptions or dividend payments, (viii) the creation, incurrence or assumption of certain types of indebtedness or liens, (ix) increasing or decreasing the size of the Company's Board of Directors and (x) appointing, hiring, suspending or terminating the employment or materially modifying the compensation of any executive officer.

The Certificate of Designations further provides that upon the occurrence of certain defined events of default each holder of Series A-1 Preferred Stock may elect to require the Company to repurchase any outstanding shares of Series A-1 Preferred Stock held by such holder for 125% of the Stated Value of such shares plus all accrued but unpaid cash dividends for such shares payable, at the holder's election, in cash or Common Stock. In addition, upon the occurrence of such event of default, the number of directors constituting the Company's Board of Directors will automatically increase by a number equal to the number of directors then constituting the Board of Directors plus one and the holders of the Series A-1 Preferred Stock are entitled to elect such additional directors.

The Warrants provide that in the event of certain fundamental transactions or the occurrence of an event of default that the holder of the Warrants may cause the Company to repurchase such Warrants for the purchase price specified therein (the "Repurchase Price").

In addition, upon the occurrence of a liquidation event (including certain fundamental transactions), the holders of the Series A-1 Preferred Stock are entitled to receive prior and in preference to the payment of any amounts to the holders of any other equity securities of the Company (the "Junior Securities") (i) 125% of the Stated Value of the outstanding shares of Series A-1 Preferred Stock, (ii) all accrued but unpaid cash dividends with respect to such shares of Series A-1 Preferred Stock and the (iii) Repurchase Price with respect to all Warrants held by such holders.

In connection with the private placement, the Company paid Noble International Investments, Inc. ("Noble") \$100,000 and issued Noble a warrant to purchase up to 1,602,565 shares of the Company's common stock for an exercise price of \$0.0780 per share.

The Company accounts for its preferred stock based upon the guidance enumerated in SFAS No. 150. The Series A-1 Preferred Stock is mandatorily redeemable on February 9, 2012 and therefore is classified as a liability instrument on the date of issuance. The Warrants issued in connection with the Series A-1 Preferred Stock provide that the holders of the Warrants may cause the Company to repurchase such Warrants for the Repurchase Price in the event of certain fundamental transactions or the occurrence of an event of default. The Company evaluated the Warrants pursuant to EITF No. 00-19 and determined that the Warrants should be classified as liabilities because they contain a provision that could require cash settlement and that event is outside the control of the Company. The Warrants should be measured at fair value, with changes in fair value reported in earnings as long as the Warrants remain classified as liabilities. The initial proceeds allocated to shares of Series A-1 Preferred Stock and the Warrants are \$4,299,274 and \$1,906,726, respectively

The Company is amortizing the warrant discount using the effective interest rate method over the three year term of the Series A-1 Preferred Stock. Although the stated interest rate of the Series A-1 Preferred Stock is 12.5%, as a result of the discount recorded for the Warrants, the effective interest rate is 26.79%. The Company also incurred approximately \$1,040,000 of costs in relation to this transaction, which were recorded as deferred financing costs to be amortized over the term of the Series A-1 Preferred Stock.

The Company calculated the fair value of the Warrants at the date of issuance using the Black-Scholes option pricing model. The change in fair value of the Warrants issued in connection with the Series A-1 Preferred Stock from the date of issuance to March 31, 2009, was an increase of approximately \$43 thousand from \$1.9 million as of February 27, 2009 to \$2.0 million as of March 31, 2009. This change of fair value of the Warrants was reflected as a component of other expense within the statement of operations for the three months ended March 31, 2009.

Loan and Security Agreement

On March 13, 2007, the Company entered into two Loan and Security Agreements with SVB, one of which provided for a revolving credit facility of up to \$10 million and the other of which provided for a working capital line of credit of up to \$12 million. SVB and the Company have agreed that the revolving credit facility has no further force or effect. The Company continues to use the working capital line of credit to borrow funds for working capital and general corporate purposes. References to the Loan and Security Agreement in this description refer to the working capital line of credit agreement. The Loan and Security Agreement is secured by a first priority perfected security interest in any and all properties, rights and assets of the Company, wherever located, whether now owned or thereafter acquired or arising and all proceeds and products thereof as described in the Loan and Security Agreement. Under the Loan and Security Agreement, the line of credit is due on demand and interest is payable monthly based on a floating per annum rate equal to the aggregate of the Prime Rate plus the applicable spread which ranges from 1.00% to 2.00%, as well as other fees and expenses as set forth more fully in the agreements. The Loan and Security Agreement, requires the Company to maintain certain EBITDA covenants as specified in the Loan and Security Agreement. Because the Company was not in compliance with the EBITDA covenant at June 30, 2008, the Company and SVB amended the Loan and Security Agreement to waive the covenant compliance for the periods ended June 30 and July 31, 2008 and provide for modified EBITDA covenant amounts for the remainder of 2008. The EBITDA covenant amounts for 2009 remain unchanged from the original agreement. The Company was not in compliance with the EBITDA covenant set forth in Section 6.7(b) of the Loan and Security Agreement as of the three month period ended March 31, 2009. SVB has waived such noncompliance. As of March 31, 2009, the Company had \$4.0 million outstanding, and \$0.5 million additional availability, under its working capital line of credit with SVB.

On March 18, 2009, the Company and SVB entered into a Second Loan Modification Agreement. This Second Loan Modification Agreement amended the Loan and Security Agreement to extend the maturity date to May 12, 2009 and modify the funds available under the working capital line of credit facility to not exceed \$4.5 million and the total funds available under the Loan and Security Agreement to a maximum amount of \$5.625 million. The interest rates and EBITDA covenant are consistent with the previous agreement for the remainder of the extension period. SVB and the Company are working on renewing the Loan and Security Agreement for an additional one-year period. Based on the term sheet provided to the Company by SVB, the Company believes that the interest rates and access to funding under the agreement will be similar to the extension agreement. The EBITDA covenant and other significant terms contained within the agreement are currently being negotiated by the Company and SVB.

On May 4, 2009, the Company and SVB entered into a Third Loan Modification Agreement. This Third Loan Modification Agreement amended the Loan and Security Agreement to extend the maturity date to June 12, 2009.

The Loan and Security Agreement contains events of default that include among other things, non-payment of principal, interest or fees, violation of covenants, inaccuracy of representations and warranties, cross default to certain other indebtedness, bankruptcy and insolvency events, change of control and material judgments. Upon occurrence of an event of default, SVB is entitled to, among other things, accelerate all obligations of the Company and sell the Company's assets to satisfy the Company's obligations under the Loan and Security Agreement.

As of March 31, 2009, 45% of the Company's total assets were in the form of accounts receivable, thus, the Company depends on the collection of its receivables to generate cash flow, provide working capital, pay down debt and continue its business operations. As of March 31, 2009, the Company had unbilled receivables of \$2.8 million included in the total accounts receivable for which it is awaiting authorization to invoice. If the federal government, any of the Company's other clients or any prime contractor for whom the Company is a subcontractor does not authorize the Company to invoice or fails to pay or delays the payment of the Company's outstanding invoices for any reason, the Company's business and financial condition may be materially adversely affected. The government may fail to pay outstanding invoices for a number of reasons, including a reduction in appropriated funding, lack of appropriated funds or lack of an approved budget.

In the event cash flows are not sufficient to fund operations at the present level and the Company is unable to obtain additional financing, it would attempt to take appropriate actions to tailor its activities to its available financing, including reducing its business operations through additional cost cutting measures and revising its business strategy. However, there can be no assurances that the Company's attempts to take such actions will be successful.

ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 4: CONTROLS AND PROCEDURES

Not applicable.

ITEM 4T: CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of the quarter ended March 31, 2009. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of March 31, 2009, the Company's disclosure controls and procedures are effective in ensuring that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms, and accumulated and communicated to the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

In connection with the evaluation required by paragraph (d) of Rule 13a-15 under the Exchange Act, there was no change identified in the Company's internal control over financial reporting that occurred during the three months ended March 31, 2009 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II: OTHER INFORMATION

ITEM 1: LEGAL PROCEEDINGS

None.

ITEM 1A: RISK FACTORS

Smaller reporting companies are not required to provide the information required by this item...

ITEM 2: UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The Company previously furnished information regarding the Company's unregistered sale, on February 27, 2009, of Series A-1 Preferred Stock and Warrants pursuant to a Current Report on Form 8-K filed with the Securities and Exchange Commission on March 3, 2009.

ITEM 3: DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4: SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5: OTHER INFORMATION

On May 11, 2009, Paradigm, PSC, CTS, Trinity (collectively, the "Borrower") and Silicon Valley Bank entered into a Waiver Agreement pursuant to which Silicon Valley Bank waived the Borrower's noncompliance with the EBITDA covenant set forth in Section 6.7(b) of the Loan and Security Agreement for the three month period ended March 31, 2009.

ITEM 6: EXHIBITS

<u>EXHIBIT NO.</u>	<u>DESCRIPTION</u>
10.1	Waiver Agreement dated May 11, 2009 among Silicon Valley Bank, Paradigm Holdings, Inc., Paradigm Solutions Corporation, Caldwell Technology Solutions LLC and Trinity Information Management Services.
31.1	Certification of CEO pursuant to Rule 13a-14(a)/ 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of CFO pursuant to Rule 13a-14(a)/ 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of CEO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of CFO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to 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.

PARADIGM HOLDINGS, INC.
(Registrant)

Date: May 14, 2009

By: /s/ Peter B. LaMontagne

Peter B. LaMontagne
President and Chief Executive Officer

Date: May 14, 2009

By: /s/ Richard Sawchak

Richard Sawchak
Senior Vice President and Chief Financial Officer

WAIVER AGREEMENT

This Waiver Agreement (this "Agreement") is entered into as of _____, 2009, by and among (a) **SILICON VALLEY BANK**, a California corporation, with its principal place of business at 3003 Tasman Drive, Santa Clara, California 95054 and with a loan production office located at One Newton Executive Park, Suite 200, 2221 Washington Street, Newton, Massachusetts 02462 ("Bank") and (b) **PARADIGM HOLDINGS, INC.**, a Wyoming corporation, with offices at 9715 Key West Avenue, Rockville, Maryland 20850 ("Holdings"), **PARADIGM SOLUTIONS CORPORATION**, a Maryland corporation, with offices at 9715 Key West Avenue, Rockville, Maryland 20850 ("Solutions"), **CALDWELL TECHNOLOGY SOLUTIONS LLC**, a Maryland limited liability company, with offices at 17001 Science Drive, Suite 100, Bowie, Maryland 20715 ("Caldwell") and **TRINITY INFORMATION MANAGEMENT SERVICES**, a Nevada corporation, with offices at 9715 Key West Avenue, Rockville, Maryland 20850 ("Trinity") (hereinafter, Holdings, Solutions, Caldwell and Trinity are jointly and severally, individually and collectively, referred to as "Borrower").

1. DESCRIPTION OF EXISTING INDEBTEDNESS AND OBLIGATIONS. Among other indebtedness and obligations which may be owing by Borrower to Bank, Borrower is indebted to Bank pursuant to a loan arrangement dated as of March 13, 2007, evidenced by, among other documents, a certain Loan and Security Agreement (working capital line of credit) dated as of March 13, 2007, among Borrower and Bank, as amended by a certain First Loan Modification Agreement dated as of August 11, 2008, as further amended by a certain Second Loan Modification Agreement dated as of March 18, 2009, and as further amended by a certain Third Loan Modification Agreement dated as of May 4, 2009 (as amended, the "Loan Agreement"). Capitalized terms used but not otherwise defined herein shall have the same meaning as in the Loan Agreement.

2. DESCRIPTION OF COLLATERAL. Repayment of the Obligations is secured by (a) the Collateral as described in the Loan Agreement, (b) the Intellectual Property Collateral as described in a certain Intellectual Property Security Agreement dated as of March 13, 2007 between Bank and Holdings (the "Holdings IP Security Agreement"), (c) the Intellectual Property Collateral as described in a certain Intellectual Property Security Agreement dated as of March 13, 2007 between Bank and Solutions (the "Solutions IP Security Agreement"), (d) the Intellectual Property Collateral as described in a certain Intellectual Property Security Agreement dated as of July 5, 2007 between Bank and Caldwell (the "Caldwell IP Security Agreement"), and (e) the Intellectual Property Collateral as described in a certain Intellectual Property Security Agreement dated as of September 5, 2007 between Bank and Trinity (the "Trinity IP Security Agreement") (together with any other collateral security granted to Bank, the "Security Documents"). Hereinafter, the Security Documents, together with all other documents evidencing or securing the Obligations shall be referred to as the "Existing Loan Documents".

3. WAIVER. Bank hereby waives Borrower's existing default under the Loan Agreement by virtue of Borrower's failure to comply with the financial covenant set forth in Section 6.7(b) of the Loan Agreement as of the three-month period ended March 31, 2009. Bank's waiver of Borrower's compliance with such covenant shall apply only to the foregoing specific period.

4. FEES. Borrower shall pay to Bank a waiver fee equal to Two Thousand Five Hundred Dollars (\$2,500.00), which fee shall be due on the date hereof and shall be deemed fully earned as of the date hereof. Borrower shall also reimburse Bank for all reasonable legal fees and expenses incurred in connection with this Agreement.

5. RATIFICATIONS OF IP SECURITY AGREEMENTS.

(a) Holdings hereby ratifies, confirms and reaffirms, all and singular, the terms and conditions of the Holdings IP Security Agreement and acknowledges, confirms and agrees that the Holdings IP Security Agreement contains an accurate and complete listing of all Intellectual Property Collateral as defined therein.

(b) Solutions hereby ratifies, confirms and reaffirms, all and singular, the terms and conditions of the Solutions IP Security Agreement and acknowledges, confirms and agrees that the Solutions IP Security Agreement contains an accurate and complete listing of all Intellectual Property Collateral as defined therein.

(c) Caldwell hereby ratifies, confirms and reaffirms, all and singular, the terms and conditions of the Caldwell IP Security Agreement and acknowledges, confirms and agrees that the Caldwell IP Security Agreement contains an accurate and complete listing of all Intellectual Property Collateral as defined therein.

(d) Trinity hereby ratifies, confirms and reaffirms, all and singular, the terms and conditions of the Trinity IP Security Agreement and acknowledges, confirms and agrees that the Trinity IP Security Agreement contains an accurate and complete listing of all Intellectual Property Collateral as defined therein.

6. RATIFICATIONS OF PERFECTION CERTIFICATES .

(a) Holdings hereby ratifies, confirms and reaffirms, all and singular, the terms and disclosures contained in a certain Perfection Certificate dated as of March 13, 2007 between Holdings and Bank, and acknowledges, confirms and agrees the disclosures and information Holdings provided to Bank in the Perfection Certificate have not changed, as of the date hereof.

(b) Solutions hereby ratifies, confirms and reaffirms, all and singular, the terms and disclosures contained in a certain Perfection Certificate dated as of March 13, 2007 between Solutions and Bank, and acknowledges, confirms and agrees the disclosures and information Solutions provided to Bank in the Perfection Certificate have not changed, as of the date hereof.

(c) Caldwell hereby ratifies, confirms and reaffirms, all and singular, the terms and disclosures contained in a certain Perfection Certificate dated as of July 5, 2007 between Caldwell and Bank, and acknowledges, confirms and agrees the disclosures and information Caldwell provided to Bank in the Perfection Certificate have not changed, as of the date hereof.

(d) Trinity hereby ratifies, confirms and reaffirms, all and singular, the terms and disclosures contained in a certain Perfection Certificate dated as of September 5, 2007 between Trinity and Bank, and acknowledges, confirms and agrees the disclosures and information Trinity provided to Bank in the Perfection Certificate have not changed, as of the date hereof.

7. CONSISTENT CHANGES . The Existing Loan Documents are hereby amended wherever necessary to reflect the changes described above.

8. RATIFICATION OF LOAN DOCUMENTS . Borrower hereby ratifies, confirms, and reaffirms all terms and conditions of all security or other collateral granted to the Bank, and confirms that the indebtedness secured thereby includes, without limitation, the Obligations.

9. NO DEFENSES OF BORROWER . Borrower hereby acknowledges and agrees that Borrower has no offsets, defenses, claims, or counterclaims against Bank with respect to the Obligations, or otherwise, and that if Borrower now has, or ever did have, any offsets, defenses, claims, or counterclaims against Bank, whether known or unknown, at law or in equity, all of them are hereby expressly WAIVED and Borrower hereby RELEASES Bank from any liability thereunder.

10. CONTINUING VALIDITY. Borrower understands and agrees that in providing the waiver set forth herein, Bank is relying upon Borrower's representations, warranties, and agreements, as set forth in the Existing Loan Documents. Except as expressly modified pursuant to this Agreement, the terms of the Existing Loan Documents remain unchanged and in full force and effect. Bank's agreement to modifications to the existing Obligations pursuant to this Agreement in no way shall obligate Bank to make any future modifications to the Obligations. Nothing in this Agreement shall constitute a satisfaction of the Obligations. It is the intention of Bank and Borrower to retain as liable parties all makers of Existing Loan Documents, unless the party is expressly released by Bank in writing. No maker will be released by virtue of this Agreement.

11. COUNTERSIGNATURE. This Agreement shall become effective only when it shall have been executed by Borrower and Bank.

[The remainder of this page is intentionally left blank]

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed as of the date first written above.

BORROWER:

PARADIGM HOLDINGS, INC.

By: /s/ Richard Sawchak

Name: Richard Sawchak

Title: SVP and CFO

PARADIGM SOLUTIONS CORPORATION

By: /s/ Richard Sawchak

Name: Richard Sawchak

Title: SVP and CFO

CALDWELL TECHNOLOGY SOLUTIONS LLC

By: /s/ Richard Sawchak

Name: Richard Sawchak

Title: SVP and CFO

TRINITY INFORMATION MANAGEMENT SERVICES

By: /s/ Richard Sawchak

Name: Richard Sawchak

Title: SVP and CFO

BANK:

SILICON VALLEY BANK

By: /s/ Silicon Valley Bank

Name: _____

Title: _____



CERTIFICATIONS

I, Peter B. LaMontagne, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2009 of Paradigm Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)), and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 14, 2009

/s/ Peter B. LaMontagne
Peter B. LaMontagne
President and Chief Executive Officer

CERTIFICATIONS

I, Richard Sawchak, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2009 of Paradigm Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)), and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 14, 2009

/s/ Richard Sawchak

Richard Sawchak

Senior Vice President and Chief Financial Officer

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Paradigm Holdings, Inc. (the "Company") for the quarterly period ended March 31, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Peter B. LaMontagne, President and Chief Executive Officer of the Company, hereby certifies pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to his knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 14, 2009

/s/ Peter B. LaMontagne

Peter B. LaMontagne
President and Chief Executive Officer

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Paradigm Holdings, Inc. and will be retained by Paradigm Holdings, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Paradigm Holdings, Inc. (the "Company") for the quarterly period ended March 31, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Richard Sawchak, the Senior Vice President and Chief Financial Officer of the Company, hereby certifies pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to his knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 14, 2009

/s/ Richard Sawchak

Richard Sawchak

Senior Vice President and Chief Financial Officer

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Paradigm Holdings, Inc. and will be retained by Paradigm Holdings, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.
