

CYALUME TECHNOLOGIES HOLDINGS, INC.

FORM 10-Q (Quarterly Report)

Filed 05/12/10 for the Period Ending 03/31/10

Address	96 WINDSOR STREET, WEST SPRINGFIELD, MA 01089
Telephone	(413) 858-2500
CIK	0001335293
Symbol	CYLU
SIC Code	3640 - Electric Lighting And Wiring Equipment
Industry	Furniture & Fixtures
Sector	Consumer Cyclical
Fiscal Year	12/31

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2010

OR

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

For the transition period from _____ **to** _____

Commission File Number 000-52247

Cyalume Technologies Holdings, Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

20-3200738

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

96 Windsor Street, West Springfield, Massachusetts

(Address of principal executive offices)

01089

(Zip Code)

(413) 858-2500

(Registrant's telephone number, including area code)

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

Smaller reporting company

(Do not check if a 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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: As of May 10, 2010, there were outstanding 15,583,737 shares of the registrant's Common Stock, par value \$.001 per share.

Cyalume Technologies Holdings, Inc.

FORM 10-Q

INDEX

PART I—FINANCIAL INFORMATION

Item 1.	Financial Statements	
	Condensed Consolidated Statements of Operations (unaudited) for the three months ended March 31, 2010 and 2009	4
	Condensed Consolidated Balance Sheets as of March 31, 2010 (unaudited) and December 31, 2009	5
	Condensed Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Loss for the three months ended March 31, 2010 (unaudited)	6
	Condensed Consolidated Statements of Cash Flows (unaudited) for the three months ended March 31, 2010 and 2009	7
	Notes to Condensed Consolidated Financial Statements (unaudited)	8
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	13
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	15
Item 4T.	Controls and Procedures	15

PART II—OTHER INFORMATION

Item 1.	Legal Proceedings	16
Item 1A.	Risk Factors	16
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	16
Item 3.	Defaults Upon Senior Securities	16
Item 4.	[Removed and Reserved]	16
Item 5.	Other Information	16
Item 6.	Exhibits	17
Signatures		18

PART I—FINANCIAL INFORMATION

The statements contained in this quarterly report on Form 10-Q, including under the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and other sections of this quarterly report, include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including, without limitation, statements regarding our or our management's expectations, hopes, beliefs, intentions or strategies regarding the future. The words "believe," "may," "will," "estimate," "continue," "anticipate," "intend," "expect," "plan" and similar expressions may identify forward-looking statements, but the absence of these words does not mean that a statement is not forward-looking. The forward-looking statements contained in this quarterly report are based on our current expectations and beliefs concerning future developments and their potential effects on us. There can be no assurance that future developments affecting us will be those that we have anticipated. These forward-looking statements involve a number of risks, uncertainties (some of which are beyond our control) or other assumptions that may cause actual results or performance to be materially different from those expressed or implied by these forward-looking statements. Should one or more of these risks or uncertainties materialize, or should any of our assumptions prove incorrect, actual results may vary in material respects from those projected in these forward-looking statements. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required under applicable securities laws. Unless the content otherwise requires, all references to "we", "us", the "Company" or "Cyalume" in this Quarterly Report on Form 10-Q refers to Cyalume Technologies Holdings, Inc.

ITEM 1. Financial Statements

Cyalume Technologies Holdings, Inc.
Condensed Consolidated Statements of Operations
(in thousands, except shares and per share information)
(Unaudited)

	For the Three Months Ended March 31, 2010	For the Three Months Ended March 31, 2009
Revenues	\$ 8,885	\$ 6,624
Cost of goods sold	4,602	3,861
Gross profit	<u>4,283</u>	<u>2,763</u>
Other expenses (income):		
Sales and marketing	788	785
General and administrative	1,513	1,225
Research and development	382	393
Interest expense, net	665	627
Interest expense – related party	16	14
Amortization of intangible assets	456	995
Other expenses (income), net	<u>(10)</u>	<u>44</u>
Total other expenses	<u>3,810</u>	<u>4,083</u>
Income (loss) before income taxes	473	(1,320)
Provision for (benefit from) income taxes	312	(547)
Net income (loss)	<u>\$ 161</u>	<u>\$ (773)</u>
Net income (loss) per common share:		
Basic	\$ 0.01	(0.05)
Diluted	\$ 0.01	(0.05)
Weighted average shares used to compute net income (loss) per common share:		
Basic	15,406,550	14,564,234
Diluted	15,447,245	14,564,234

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

Cyalume Technologies Holdings, Inc.
Condensed Consolidated Balance Sheets
(in thousands, except shares and per share information)

	March 31, 2010 (unaudited)	December 31, 2009
Assets		
Current assets:		
Cash	\$ 1,560	\$ 2,003
Accounts receivable, net of allowance for doubtful accounts of \$228 and \$239 at March 31, 2010 and December 31, 2009, respectively	4,113	3,319
Inventories, net	9,524	9,320
Income taxes refundable	274	294
Deferred income taxes	847	682
Prepaid expenses and other current assets	328	382
Total current assets	16,646	16,000
Property, plant and equipment, net	8,477	8,384
Goodwill	51,244	51,244
Other intangible assets, net	22,072	22,548
Other noncurrent assets	57	67
Total assets	\$ 98,496	\$ 98,243
Liabilities and Stockholders' Equity		
Current liabilities:		
Lines of credit	\$ 3,200	\$ 3,200
Current portion of notes payable	7,075	6,940
Accounts payable	3,794	3,222
Accrued expenses and other current liabilities	2,187	2,069
Advance due to related parties	9	9
Total current liabilities	16,265	15,440
Notes payable, net of current portion	17,816	18,874
Notes payable due to related parties	1,080	1,065
Deferred income taxes	7,285	7,105
Derivatives	189	69
Asset retirement obligation, net of current portion	160	158
Total liabilities	42,795	42,711
Commitments and contingencies	—	—
Stockholders' equity:		
Preferred stock, \$0.001 par value; 1,000,000 shares authorized, no shares issued or outstanding	—	—
Common stock, \$0.001 par value; 50,000,000 shares authorized; 15,583,737 and 15,405,570 shares issued and outstanding at March 31, 2010 and December 31, 2009, respectively	16	15
Additional paid-in capital	88,397	87,926
Accumulated deficit	(32,232)	(32,393)
Accumulated other comprehensive loss	(480)	(16)
Total stockholders' equity	55,701	55,532
Total liabilities and stockholders' equity	\$ 98,496	\$ 98,243

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

Cyalume Technologies Holdings, Inc.
Condensed Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Loss
(in thousands, except shares)
(Unaudited)

	<u>Common Stock</u>		<u>Additional Paid-In Capital</u>	<u>Accumulated Deficit</u>	<u>Accumulated</u>	<u>Total Stockholders' Equity</u>	<u>Comprehensive Loss</u>
	<u>Number of Shares</u>	<u>Amount</u>			<u>Other Comprehensive Loss</u>		
Balance at December 31, 2009	15,405,570	\$ 15	\$ 87,926	\$ (32,393)	\$ (16)	\$ 55,532	\$ —
Stock issued	178,167	1	(1)	—	—	—	—
Stock-based compensation expense	—	—	472	—	—	472	—
Foreign currency translation adjustments	—	—	—	—	(389)	(389)	(389)
Unrealized loss on cash flow hedges, net of taxes of \$45	—	—	—	—	(75)	(75)	(75)
Net income	—	—	—	161	—	161	161
Comprehensive loss	—	—	—	—	—	—	<u>\$ (303)</u>
Balance at March 31, 2010	<u>15,583,737</u>	<u>\$ 16</u>	<u>\$ 88,397</u>	<u>\$ (32,232)</u>	<u>\$ (480)</u>	<u>\$ 55,701</u>	

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

Cyalume Technologies Holdings, Inc.
Condensed Consolidated Statements of Cash Flows
(in thousands, except shares)
(Unaudited)

	For the Three Months Ended March 31, 2010	For the Three Months Ended March 31, 2009
Cash flows from operating activities:		
Net income (loss)	\$ 161	\$ (773)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation of property, plant and equipment	164	158
Amortization	540	1,312
Provision for deferred income taxes	109	(642)
Stock-based compensation expense	472	35
Other non-cash expenses	57	92
Changes in operating assets and liabilities:		
Accounts receivable	(867)	83
Inventories	(314)	(331)
Prepaid expenses and other current assets	44	(166)
Accounts payable and accrued liabilities	723	(137)
Income taxes payable, net	3	(88)
Accrued interest on notes payable to stockholders	—	(1)
Net cash provided by (used in) operating activities	1,092	(458)
Cash flows from investing activities:		
Purchases of long-lived assets	(463)	(111)
Net cash used in investing activities	(463)	(111)
Cash flows from financing activities:		
Payments for common stock subject to redemption	—	(1,123)
Net repayment of line of credit	—	(200)
Repayment of notes payable	(1,030)	(658)
Payments to reacquire and retire common stock	—	(263)
Refund of debt issue costs	—	10
Proceeds from exercises of warrants	—	27
Net cash used in financing activities	(1,030)	(2,207)
Effect of exchange rate changes on cash	(42)	27
Net decrease in cash	(443)	(2,749)
Cash, beginning of period	2,003	3,952
Cash, end of period	\$ 1,560	\$ 1,203

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

Cyalume Technologies Holdings, Inc.
Notes to Condensed Consolidated Financial Statements

1. BASIS OF PRESENTATION

We have prepared the accompanying unaudited interim condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, these interim condensed consolidated financial statements do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America for complete financial statements.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period.

These accompanying unaudited interim condensed consolidated financial statements recognize the effects of all subsequent events that provide additional evidence about conditions that existed at March 31, 2010, including the estimates inherent in the process of preparing financial statements. Additionally, all significant intercompany accounts and transactions have been eliminated in consolidation.

Certain amounts in prior periods have been reclassified to conform to the 2010 presentation. These reclassifications had no effect on our financial position or operating results as previously reported.

We believe all adjustments (consisting of normal, recurring adjustments) considered necessary for a fair presentation have been included in these unaudited interim condensed consolidated financial statements. Operating results for the three-month periods presented are not necessarily indicative of the results that may be expected for any other interim period or for the full year. The consolidated balance sheet at December 31, 2009 has been derived from the audited consolidated financial statements at that date. We suggest that these unaudited interim condensed consolidated financial statements be read in conjunction with the consolidated financial statements and footnotes thereto in our Annual Report on Form 10-K for the year ended December 31, 2009.

2. BACKGROUND AND DESCRIPTION OF BUSINESS

We have one subsidiary: Cyalume Technologies, Inc. (“CTI”), whose headquarters are also located in West Springfield, MA. CTI has one subsidiary, Cyalume Technologies, SAS (“CTSAS”), located in Aix-en-Provence, France. Our products are manufactured at both the West Springfield and Aix-en-Provence locations.

We primarily produce products based on technologies whereby light is generated through a chemical reaction known as chemiluminescence. CTI manufactures and sells such chemiluminescent products, in addition to reflective and photoluminescent products, to military, commercial and public safety markets. Our base product is known as a “light stick” and is typically 6 inches in length. A light stick is a translucent flexible plastic tube that is partly filled with one chemical ingredient and also with a glass container (“ampoule”) that contains a complementary reactive chemical. When the tube is bent enough to break the glass ampoule, the chemicals contained within the plastic tube mix and light is generated. Additionally, we manufacture and sell a component of 40mm training ammunition; sales of these components have been an increasing source of our revenues in recent years. Also, we produce reflective (patches) and reflective plus photoluminescent (fire tape) products. Based on our customers’ specifications, our products are manufactured in varying shapes, sizes and functions, and provide light in different colors, intensity and durations.

3. NEW ACCOUNTING PRONOUNCEMENTS

The following are recent accounting pronouncements that have affected our consolidated financial statements or may affect them in the future.

In January 2010, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2010-06, *Improving Disclosures about Fair Value Measurements*, to amend existing guidance in FASB Accounting Standards Codification (“ASC”) 820, *Fair Value Measurements and Disclosures*, to expand and clarify existing disclosures regarding recurring and nonrecurring fair value measurements. The amendments in this ASU were effective on January 1, 2010 for our interim and annual reporting. The adoption of this ASU did not have an impact on these unaudited interim condensed consolidated financial statements.

Cyalume Technologies Holdings, Inc.
Notes to Condensed Consolidated Financial Statements

In February 2010, the FASB issued ASU No. 2010-09, *Subsequent Events (Topic 855): Amendments to Certain Recognition and Disclosure Requirements*. The amendments in this ASU remove the requirement for an SEC filer (such as us) to disclose a date through which subsequent events have been evaluated in both issued and revised financial statements. Revised financial statements include financial statements revised as a result of either correction of an error or retrospective application of U.S. GAAP. All of the amendments in this ASU were effective for us upon the FASB's issuance of ASU No. 2010-09. The only effect of our adoption of this ASU on these unaudited interim condensed consolidated financial statements was to not disclose the date through which subsequent events have been evaluated in preparing these consolidated financial statements; for SEC filers, that evaluation date must be the date of issuance of the financial statements.

4. INVENTORIES

Inventories consist of the following (all amounts in thousands):

	March 31, 2010	December 31, 2009
Raw materials, net	\$ 4,981	\$ 4,548
Work-in-process, net	2,795	2,973
Finished goods, net	1,748	1,799
	<u>\$ 9,524</u>	<u>\$ 9,320</u>

5. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The derivative liabilities as of March 31, 2010 in our condensed consolidated balance sheet consist of the following (all amounts in thousands):

Derivative Instrument	Balance Sheet Location	Fair Value
Interest rate swaps	Derivatives (noncurrent liabilities)	\$ (189)
Currency forward contract	Accrued expenses and other current liabilities (current liabilities)	(2)

We have not held any other types of derivative instruments other than the derivatives listed above.

Interest Rate Swaps

In December 2008, we entered into two pay-fixed, receive-variable, interest rate swaps to reduce exposure to changes in cash payments caused by changes in interest rates on our notes payable with TD Bank, N.A. Both relationships are designated as cash flow hedges and meet the criteria for the shortcut method for assessing hedge effectiveness; therefore, the hedge is assumed to be 100% effective and all changes in the fair value of the interest rate swaps are recorded in comprehensive income (loss). These unrealized gains and losses must be reclassified in whole or in part into earnings if, and when, a comparison of the swap(s) and the related hedged cash flows demonstrates that the shortcut method is no longer applicable. We expect these hedges to meet the criteria of the shortcut method for the duration of the hedging relationship, which ends upon maturity of the notes payable, and therefore we do not expect to reclassify any portion of these unrealized losses from comprehensive income (loss) to earnings in the future. The fair values of the swaps are determined by discounting the estimated cash flows to be received and paid due to the swaps over the swap's contractual lives using an estimated risk-free interest rate for each swap settlement date.

Currency Forward Contracts

CTSAS' functional currency is the Euro. Periodically, CTSAS purchases inventory from CTI, which requires payment in U.S. dollars. Beginning in 2009 and only under certain circumstances, we use currency forward contracts to mitigate CTSAS' exposure to changes in the Euro-to-U.S.-dollar exchange rate upon CTSAS' payment to CTI for these inventory purchases. Such currency forward contracts typically have durations of less than six months. We report these currency forward contracts at their fair value. This relationship has not been designated as a hedge and therefore all changes in these currency forward contracts' fair value are recorded in other expenses (income) on our condensed consolidated statement of operations. The fair value of these contracts is determined by taking the difference between (a) the U.S. dollar amount due on the contract at maturity and (b) the present value of estimated cash flows developed using, among other data, expectations of future currency exchange rates over the remaining term of the contract discounted at an estimated risk-free interest rate. At March 31, 2010, we held three such currency forward contracts.

Cyalume Technologies Holdings, Inc.
Notes to Condensed Consolidated Financial Statements

Effect of Derivatives on Statement of Operations

The effect of derivative instruments (a) designated as cash flow hedges and (b) not designated as hedging instruments on our condensed consolidated statement of operations for the three months ended March 31, 2010 was as follows (all amounts in thousands):

	<u>Gain (Loss) In AOCL ⁽¹⁾</u>	<u>Gain (Loss) Reclassified ⁽²⁾</u>	<u>Gain (Loss) in Earnings ⁽³⁾</u>
Derivatives in cash flow hedging relationships:			
Interest rate swaps	\$ (75)	\$ —	\$ —
Derivatives not designated as hedging instruments:			
Forward currency contracts	\$ —	\$ —	\$ (24)

(1) Amount recognized in accumulated other comprehensive loss (AOCL) (effective portion and net of taxes) during the three months ended March 31, 2010.

(2) Amount of gain (loss) originally recorded in AOCL but reclassified from AOCL into earnings during the three months ended March 31, 2010.

(3) Amount of gain (loss) recognized in earnings on the derivative (ineffective portion and amount excluded from effectiveness testing) reported in other expenses (income), net on the condensed consolidated statement of operations for the three months ended March 31, 2010.

6. INCOME TAXES

For the three months ended March 31, 2010, the effective tax rate of 66% differed from the statutory rate of 34% due to the valuation allowance on foreign tax credits that were generated by unrepatriated earnings of CTSAS. For the three months ended March 31, 2009, the effective tax rate of 41% differed from the statutory rate of 34% due to state and foreign taxes.

7. NET INCOME (LOSS) PER COMMON SHARE

Basic net income (loss) per common share is computed by dividing net income (loss) by the weighted average number of common shares outstanding. Diluted net income per common share is computed by dividing net income by the weighted average number of common shares and dilutive potential common share equivalents then outstanding. Potential common shares consist of shares issuable upon the exercise of warrants and options (using the treasury stock method).

	<u>Three Months Ended March 31,</u>	
	<u>2010</u>	<u>2009</u>
Basic:		
Net income (loss) (in thousands)	\$ 161	\$ (773)
Weighted average shares	15,406,550	14,564,234
Basic income (loss) per common share	\$ 0.01	\$ (0.05)
Diluted:		
Net income (loss) (in thousands)	\$ 161	\$ (773)
Weighted average shares	15,406,550	14,564,234
Effect of dilutive potential common share equivalents	40,695	—(1)
Weighted average shares, as adjusted	15,447,245	14,564,234
Diluted income (loss) per common share	\$ 0.01	\$ (0.05)

(1) Since we experienced a loss during the three months ended March 31, 2009, common shares issuable upon exercise of convertible securities were excluded from the loss per share calculation because the effect would be antidilutive.

Cyalume Technologies Holdings, Inc.
Notes to Condensed Consolidated Financial Statements

The following common shares issuable upon exercise of potential common share equivalents were excluded from the calculation of diluted net income (loss) per common share because their effect was antidilutive for each of the periods presented:

	Three Months Ended	
	March 31,	
	2010	2009
Warrants	4,250,756	4,220,256
Options	2,060,000	1,462,500

8. COMMITMENTS AND CONTINGENCIES

Legal

We acquired CTI on December 19, 2008. As part of that acquisition, we acquired CTI's exposure to litigation that existed at the acquisition date. On January 23, 2006, the former owners of CTI (from whom we purchased CTI) acquired all of the outstanding capital stock of Omniglow Corporation (the "Transaction") and changed the name of the company to Cyalume Technologies, Inc. Prior to, or substantially simultaneously with, the Transaction, CTI sold certain assets and liabilities related to Omniglow Corporation's novelty and retail business to certain former Omniglow Corporation stockholders and management ("the Omniglow Buyers"). This was done because CTI sought to retain only the Omniglow Corporation assets and current liabilities associated with its government, military and safety business. During 2006, CTI and the Omniglow Buyers commenced litigation and arbitration proceedings against one another. Claims include breaches of a lease and breaches of various other agreements between CTI and the Omniglow Buyers. The Omniglow Buyers seek compensatory damages of \$1.4 million, to be trebled, and recovery of costs and legal fees. We have filed for damages of \$368,000 against the Omniglow Buyers. We continue to rigorously defend our position on these matters, as we believe the Omniglow Buyers' claims to be without merit. We do not expect this legal proceeding will have a material adverse effect on our future consolidated financial position, operating results, or cash flows.

Management Agreement with Board Member

On October 1, 2009, we entered into a Management Agreement with Selway Capital, LLC ("Selway") that provides for (but is not limited to) the following services to be performed by Selway on our behalf:

- Strategic development and implementation as well as consultation to our chief executive officer on a regular basis as per his reasonable requests;
- Identifying strategic partners with companies with which Selway has relationships and access. In this connection, Selway will focus on building partnerships with companies in Israel, Singapore, India and Europe. The focus will be on the expansion of our munitions business;
- Advise and support us on our investor relations strategy;
- Advise and support our future fund raising, including identifying sources of capital in the United States; and
- Support our mergers and acquisitions strategy and play an active role in our due diligence and analysis.

The Management Agreement stipulates that these services will be performed by Yaron Eitan, a member of our Board of Directors and an employee of Selway, with the assistance as needed from other employees of Selway. The Management Agreement is retroactive to August 1, 2009, expires on October 1, 2012 and can be terminated by either us or Selway upon 30-days' written notice or upon our default in payment or Selway's failure to perform services under the Management Agreement. Selway's compensation for these services will be \$41,667 per month for the duration of the Management Agreement. However, we are only required to pay \$16,000 per month, with the balance of \$25,667 per month remaining unpaid until our senior lender consents to such payment. We will also reimburse Selway for costs incurred specifically on our behalf for these services. Under the Management Agreement, we indemnify Selway and Selway indemnifies us against certain losses that may be incurred while carrying out its obligations under the Management Agreement.

9. FAIR VALUE

Under U.S. GAAP, we are required to record certain financial assets and liabilities at fair value and may choose to record other financial assets and financial liabilities at fair value as well. Also under U.S. GAAP, we are required to record nonfinancial assets and liabilities at fair value due to events that may or may not recur in the future, such as an impairment event. When we are required to record such assets and liabilities at fair value, that fair value is estimated using an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. That fair value is determined using inputs based on a fair value hierarchy that is based on significant levels of inputs as follows:

Level 1 Quoted prices for identical assets or liabilities in active markets to which we have access at the measurement date.

Level 2 Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 Unobservable inputs for the asset or liability.

The determination of where assets and liabilities fall within this hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

As of March 31, 2010, our only assets and liabilities required to be reported at fair value on a recurring basis were the interest rate swaps and currency forward contracts described in Note 5, both of which are measured at fair value using level 2 inputs.

We have other non-derivative financial instruments, such as cash, accounts receivable, accounts payable, accrued expenses and long-term debt, whose carrying amounts approximate fair value.

10. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Cash Paid for Interest and Income Taxes (all amounts in thousands):

	Three Months Ended March 31,	
	2010	2009
Interest	\$ 628	\$ 434
Income taxes	\$ 202	\$ 833

Non-Cash Investing and Financing Activities (all amounts in thousands):

	Three Months Ended March 31,	
	2010	2009
Accrual of costs directly related to the acquisition of CTI recorded as goodwill	\$ —	\$ 234

11. SUBSEQUENT EVENT

We entered into a Second Amendment to Credit Agreement and Limited Waiver (the "Second Loan Amendment") with TD Bank, N.A. that became effective December 17, 2009 and amended our Revolving Credit and Term Loan Agreement with TD Bank, N.A. (the "Original Credit Agreement") dated as of December 19, 2008 and all previous amendments to the Original Credit Agreement. That Second Loan Amendment, among other things, requires us to receive at least \$3.0 million in new subordinated debt or from an equity offering before April 30, 2010 and to use the net proceeds from that subordinated debt or equity offering to reduce the outstanding principal balance on our notes payable with TD Bank, N.A. TD Bank, N.A. has agreed to extend that deadline to June 30, 2010. We are currently negotiating a transaction that (i) will satisfy TD Bank, N.A.'s \$3.0 million requirement and (ii) is expected to be completed before the June 30, 2010 deadline. The cost of extending that deadline is not expected to be material.

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

You should read the following discussion of our financial condition and results of operations in conjunction with our interim condensed consolidated financial statements and the accompanying notes to those financial statements included elsewhere in this Quarterly Report on Form 10-Q. This discussion contains forward-looking statements that involve risks and uncertainties. Unless the content otherwise requires, all references to "we", "us", the "Company" or "Cyalume" in this Quarterly Report on Form 10-Q refers to Cyalume Technologies Holdings, Inc.

Company Overview

We primarily produce products based on technologies whereby light is generated through a chemical reaction known as chemiluminescence. CTI manufactures and sells such chemiluminescent products, in addition to reflective and photoluminescent products, to military, commercial and public safety markets. Our base product is known as a "light stick" and is typically 6 inches in length. A light stick is a translucent flexible plastic tube that is partly filled with one chemical ingredient and also with a glass container ("ampoule") that contains a complementary reactive chemical. When the tube is bent enough to break the glass ampoule, the chemicals contained within the plastic tube mix and light is generated. Additionally, we manufacture and sell a component of 40mm training ammunition; sales of these components have been an increasing source of our revenues in recent years. Also, we produce reflective (patches) and reflective plus photoluminescent (fire tape) products. Based on our customers' specifications, our products are manufactured in varying shapes, sizes and functions, and provide light in different colors, intensity and durations.

We have one subsidiary: Cyalume Technologies, Inc. ("CTI"), whose headquarters are also located in West Springfield, MA. CTI has one subsidiary, Cyalume Technologies, SAS ("CTSAS"), located in Aix-en-Provence, France. Our products are manufactured at both the West Springfield and Aix-en-Provence locations.

Material Changes in Results of Operations – 3 Months Ended March 31, 2010 versus the 3 Months Ended March 31, 2009

Revenues: For the three-month period ended March 31, 2010, our sales were higher than our sales for the comparable period in 2009. This increase in sales is due primarily to the volume of units sold. Price increases provided some of the additional revenues and product mix remained relatively unchanged between the two periods.

Cost of goods sold: For the three-months ended March 31, 2010, our cost of sales was significantly higher than our cost of sales for the comparable period in 2009 due to the increase in units sold discussed above. Our gross margin for the three months ended March 31, 2010 was 48.2% compared to our 41.7% gross margin for the comparable prior-year period. 2010 margin improved partially due to price increases implemented in late 2009. Gross margin in the three months ended March 31, 2009 was depressed due to lower-than-normal sales of high margin chemical light sticks to the U.S. Military, the cost of a March 2009 workforce reduction and the amortization of \$262,000 of the inventory step-up to fair market value arising from our acquisition of CTI in December 2008.

General and administrative expenses increased primarily due to expense related to the accrual of share-based awards in 2010, which were not accrued in the first quarter of 2009, and management fees relating to our management agreement with Selway Capital, LLC, which had not yet been entered into as of March 31, 2009.

Amortization of intangible assets: In December 2009, we recorded significant impairments on our trademark and customer relationship intangible assets that significantly reduced our amortization of intangible assets in the three months ended March 31, 2010 versus the three months ended March 31, 2009.

Provision for (benefit from) income taxes increased significantly for the three months ended March 31, 2010 as compared to the three months ended March 31, 2009 due to our generation of net income during the three months ended March 31, 2010 and operating losses during the three months ended March 31, 2009.

Material Changes in Financial Condition – March 31, 2010 versus December 31, 2009

Neither total assets nor total liabilities changed significantly from December 31, 2009 to March 31, 2010, however the following components of total assets and total liabilities did change significantly during that time period.

Our accounts receivable increased significantly due to higher sales during the three months ending March 31, 2010 versus the three months ending December 31, 2009. Due to these increased sales, we purchased a higher than usual amount of raw material inventory during the three months ending March 31, 2010, causing total inventory to increase from amounts on hand at December 31, 2009. This caused our accounts payable and accrued liabilities to increase during this time period as well. Our notes payable decreased significantly due to scheduled principal payments made during the first three months of 2010. Our derivatives liability increased significantly since December 31, 2009 primarily due to a decrease in estimated future LIBOR rates used to estimate the fair value of our pay fixed/receive LIBOR interest rate swaps. Our deferred tax liability increased since December 31, 2009 due to (i) amortization of identified intangible assets for U.S. GAAP purposes which is not allowed for income tax purposes; (ii) various changes in the reserve accounts, including increases in unvested stock-based compensation awards; (iii) utilization of net operating losses during the three months ended March 31, 2010; and (iv) unrepatriated earnings of our foreign subsidiary (CTSAS).



Liquidity and Capital Resources

As of March 31, 2010 and December 31, 2009, we had \$1.6 million and \$2.0 million, respectively, in cash on hand. The major sources and uses of cash during the three months ended March 31, 2010 were all in the normal course of business.

Before June 30, 2010, we expect to receive proceeds from a subordinated debt offering or an equity offering. The terms of that transaction are currently being negotiated and therefore the full effects of that transaction on our liquidity and capital resources cannot be determined. In addition to providing us with working capital, this transaction will allow us to satisfy the requirement imposed by our senior lender, TD Bank, N.A., to receive at least \$3.0 million from new subordinated debt or an equity offering before June 30, 2010 and to use the proceeds thereof to reduce the outstanding principal balance on our notes payable to TD Bank, N.A.

Forecasted principal and interest payments on bank debt for the next 12 months are \$9.1 million, including the \$3.0 million principal payment to TD Bank discussed in the preceding paragraph, and will be funded from operating cash flows and from the transaction discussed in the preceding paragraph. All other operating and capital expenditures are expected to be funded completely from operating cash flows.

Off-Balance Sheet Arrangements

Other than immaterial operating leases, we did not have any off-balance sheet arrangements during 2010 or 2009.

Contractual Obligations

As a smaller reporting company, we are not required to provide information typically disclosed under this item.

Critical Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Estimates are used when accounting for certain items such as reserves for inventory, accounts receivable and deferred tax assets; assessing the carrying value of intangible assets including goodwill; determining the useful lives of property, plant and equipment and intangible assets; and in determining asset retirement obligations. Estimates are based on historical experience, where applicable, and assumptions that we believe are reasonable under the circumstances. Due to the inherent uncertainty involved with estimates, actual results may differ.

Revenue Recognition

Revenue from the sale of products is recognized when the earnings process is complete and the risks and rewards of ownership have transferred to the customer. Costs and related expenses to manufacture the products are recorded as costs of goods sold when the related revenue is recognized.

We have several significant contracts providing for the sale of indefinite quantities of items at fixed per unit prices, subject to adjustment for certain economic factors. Revenue under these contracts is recognized when goods ordered under the contracts are received by the customer. Whenever costs change, we review the pricing under these contracts to determine whether they require the sale of products at a loss. To date, we have no loss contracts which would require the accrual of future losses in the current financial statements.

Income Taxes

Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using enacted tax rates and laws that will be in effect when the differences are expected to reverse. Deferred tax assets are recognized when, based upon available evidence, realization of the assets is more likely than not.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefit associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

We classify interest on tax deficiencies as interest expense and income tax penalties as other miscellaneous expenses.

Goodwill

Goodwill is deemed to have an indefinite life and accordingly, is not subject to annual amortization. Goodwill is subject to annual impairment reviews, and, if conditions warrant, interim reviews based upon its estimated fair value. Impairment charges, if any, are recorded in the period in which the impairment is determined.

Intangible Assets

Intangible assets include developed technologies and patents, customer relationships and non-compete agreements, which are amortized over their estimated useful lives, and trademarks and trade names, which are considered to have indefinite useful lives and therefore are not amortized. The carrying amounts of intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that those carrying amounts may not be recoverable. Costs incurred to renew or extend the term of our intangible assets are expensed when incurred.

Inventories

Inventories are stated at the lower of cost (on a first-in first-out (“FIFO”) method) or net realizable value. We periodically review the realizability of our inventory. Provisions are recorded and reserves are established for potential obsolescence. Determining adequate reserves for inventory obsolescence requires management’s judgment. Conditions impacting the realizability of our inventory could cause actual write-offs to be materially different than reported inventory reserve balances.

Foreign Operations and Currency

Accounts of our foreign subsidiary are recorded using their local currency (the euro) as the functional currency. For consolidation purposes, income statement accounts are converted to U.S. dollars using the average exchange rate for the monthly period being reported. Assets and liabilities are converted to U.S. dollars using the exchange rate in effect as of the balance sheet date. Equity transactions are converted to U.S. dollars using the exchange rate in effect as of the date of the transaction. Translation gains and losses are reported as a component of accumulated other comprehensive income or loss. Gains and losses resulting from transactions which are denominated in other than the functional currencies are reported as other income or expenses in the statement of operations in the period the gain or loss occurred.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a smaller reporting company, we are not required to provide information typically disclosed under this item.

ITEM 4T. CONTROLS AND PROCEDURES

Disclosure controls and procedures

Disclosure controls and procedures are designed to ensure that information required to be disclosed by us in reports filed or submitted under the Securities Exchange Act of 1934 (“Exchange Act”) is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls include, without limitation, controls and procedures designed to ensure that information required to be disclosed under the Exchange Act is accumulated and communicated to management, including principal executive and financial officers, as appropriate, to allow timely decisions regarding required disclosure. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

Our management carried out an evaluation, under the supervision of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of March 31, 2010. Based upon that evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that the design and operation of our disclosure controls and procedures were effective as of March 31, 2010.

Changes in internal control over financial reporting

There was no change in our internal control over financial reporting that occurred during the three months ended March 31, 2010 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Cyalume is not currently a named party in any legal proceedings.

CTI is currently named a defendant in Civil Action No. 06-706 in Superior Court of the State of Massachusetts. Filing suit against CTI is Omniglow, LLC (the former novelty business of CTI which was sold on January 23, 2006). CTI sold certain assets and liabilities related to the novelty and retail business to certain former shareholders and management (the “Omniglow Buyers”). This was done because CTI sought to retain only the Omniglow Corporation business activities associated with government, military and safety business. During 2006, CTI and the Omniglow Buyers commenced litigation and arbitration proceedings against one another. Claims include breaches of a lease and breaches of various other agreements between CTI and the Omniglow Buyers. The Omniglow Buyers seek compensatory damages of \$1.4 million, to be trebled, and recovery of costs and legal fees. CTI has filed for damages of \$368,000 against the Omniglow Buyers. CTI continues to rigorously defend our position on these matters, as we believe the Omniglow Buyers’ claims to be without merit. Court hearings were held and completed in October 2008.

ITEM 1A. RISK FACTORS

As a smaller reporting company, we are not required to provide information typically disclosed under this item.

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

Recent sales of unregistered securities and use of proceeds from registered securities

None.

Purchases of Equity Securities by the Company and Affiliated Purchasers

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. [REMOVED AND RESERVED]

ITEM 5. OTHER INFORMATION

There were no changes to the procedures by which security holders may recommend nominees to our Board of Directors during the three months ended March 31, 2010.

There is no information to report under this Item in lieu of reporting that information on Form 8-K.

ITEM 6. EXHIBITS

Exhibit Number	Description
10.1	Supply Agreement between Cyalume Technologies, Inc. and the U.S. Department of Defense, dated January 22, 2010 (confidential treatment has been requested for certain portions of this agreement which have been redacted). (1)
31.1	* Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	* Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	* Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Filed herewith.

(1) Incorporated by reference to (a) the Current Report on Form 8-K dated January 27, 2010 and filed with the Commission February 1, 2010 and (b) Exhibit 10.27 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2009 filed on March 22, 2010.

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.

Cyalume Technologies Holdings, Inc.

Date: May 12, 2010

By: /s/ DEREK DUNAWAY

Derek Dunaway,
Chief Executive Officer
(Principal Executive Officer)

Date: May 12, 2010

By: /s/ MICHAEL BIELONKO

Michael Bielonko,
Chief Financial Officer
(Principal Financial Officer and
Chief Accounting Officer)

CERTIFICATION

I, Derek Dunaway, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Cyalume Technologies 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 12, 2010

/s/ DEREK DUNAWAY

Derek Dunaway,
Chief Executive Officer

CERTIFICATION

I, Michael Bielonko, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Cyalume Technologies 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 12, 2010

/s/ MICHAEL BIELONKO

Michael Bielonko,
Chief Financial Officer

CERTIFICATION

Each of the undersigned officers of Cyalume Technologies Holdings, Inc. (the "Company") hereby certifies that, to his knowledge, the Company's Quarterly Report on Form 10-Q to which this certification is attached (the "Report"), as filed with the Securities and Exchange Commission on the date hereof, fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 12, 2010

/s/ DEREK DUNAWAY

Derek Dunaway,
Chief Executive Officer
(Principal Executive Officer)

Date: May 12, 2010

/s/ MICHAEL BIELONKO

Michael Bielonko,
Chief Financial Officer
(Principal Financial Officer and
Chief Accounting Officer)

This certification is being furnished and not filed, and shall not be incorporated into any document for any purpose, under the Securities Exchange Act of 1934 or the Securities Act of 1933.
