

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2003 AND 2002

ASSETS	2003	2002
CURRENT ASSETS:		
Cash	\$ 5,866,892	\$ 2,513,524
Cash-restricted		432,655
Accounts receivable—trade, including retainages of \$0 and \$1,220,886 in 2003 and 2002, respectively, net of allowance for doubtful accounts of \$139,945 and \$115,317 in 2003 and 2002, respectively	5,851,903	6,446,439
Costs and profits in excess of billings on uncompleted contracts	4,962,860	8,381,813
Advances to employees	8,043	16,668
Income tax receivable	130,435	324,901
Other current assets	385,418	582,985
Total current assets	<u>17,205,551</u>	<u>18,698,985</u>
 PROPERTY AND EQUIPMENT—Net (Note 4)	 <u>5,403,692</u>	 <u>8,317,815</u>
 OTHER ASSETS:		
Goodwill	293,032	293,032
Accounts receivable retainages—less current portion	34,407	272,057
Other assets	49,764	51,073
Total other assets	<u>377,203</u>	<u>616,162</u>
 DEFERRED INCOME TAX ASSETS—Net of valuation allowance of \$23,095,552 and \$22,673,129 in 2003 and 2002, respectively (Note 8)	 _____	 _____
 TOTAL ASSETS	 <u>\$22,986,446</u>	 <u>\$27,632,962</u>

(Continued)



NAC International Inc.

**CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2003 AND 2002**

LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)	2003	2002
CURRENT LIABILITIES:		
Accounts payable	\$ 5,221,088	\$ 5,441,461
Accrued expenses and other payables (Note 11)	5,096,293	12,209,006
Accrued interest to EDIC (Note 11)	3,159,081	824,838
Settlement payment due to Pinnacle West (Note 12)		9,688,007
Deferred revenue	3,860,805	3,689,571
Accrued income taxes		89,774
Current portion of capital lease obligations (Note 6)	105,651	462,921
Current portion of nonrevolving line of credit (Note 11)	39,000,000	
Current portion of term note payable (Note 5)	800,000	1,000,000
Provision for losses on contracts	454,152	4,730,649
Total current liabilities	<u>57,697,070</u>	<u>38,136,227</u>
 NONREVOLVING LINE OF CREDIT (Note 11)		35,000,000
 CAPITAL LEASE OBLIGATIONS—Less current portion (Note 6)		307,650
 TERM NOTE PAYABLE—Less current portion (Note 5)	800,000	1,600,000
 OTHER LONG-TERM LIABILITIES	454,137	455,976
 STOCKHOLDERS' EQUITY (DEFICIT):		
Class A common stock, par value \$.01 per share— authorized 1,054,450,000 and 399,450,000 shares in 2003 in 2002, respectively; issued and outstanding 1,053,714,701 and 12,631,501 in 2003 and 2002, respectively	10,537,148	126,316
Class B common stock, par value \$.01 per share— authorized 550,000 shares; issued and outstanding 300,833 in 2003 and 2002	3,008	3,008
Additional paid-in capital	12,708,144	12,708,144
Other comprehensive loss	(71,871)	(145,574)
Retained deficit	(59,141,190)	(60,558,785)
Total stockholders' equity (deficit)	<u>(35,964,761)</u>	<u>(47,866,891)</u>
 TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)	 <u>\$ 22,986,446</u>	 <u>\$ 27,632,962</u>

(Concluded)

See notes to consolidated financial statements.

NAC International Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
YEARS ENDED DECEMBER 31, 2003 AND 2002

	2003	2002
REVENUES:		
Engineering and transportation services	\$ 48,606,382	\$ 55,975,374
Consulting and energy information services	<u>8,893,321</u>	<u>10,510,389</u>
Total revenues	<u>57,499,703</u>	<u>66,485,763</u>
COSTS AND EXPENSES:		
Operating costs	42,619,610	96,085,734
General and administrative	7,395,122	9,793,323
Research and development costs	953,261	1,806,054
Depreciation and amortization	2,503,022	2,679,701
Write-off of equipment (Note 12)	<u> </u>	<u>1,767,953</u>
Total costs and expenses	<u>53,471,015</u>	<u>112,132,765</u>
OPERATING INCOME (LOSS)	4,028,688	(45,647,002)
INTEREST INCOME AND OTHER	6,183	8,310
INTEREST EXPENSES	<u>(2,568,453)</u>	<u>(1,613,580)</u>
INCOME (LOSS) BEFORE INCOME TAXES	1,466,418	(47,252,272)
INCOME TAX EXPENSE (Note 8)	<u>48,823</u>	<u> </u>
NET INCOME (LOSS)	<u>1,417,595</u>	<u>(47,252,272)</u>
OTHER COMPREHENSIVE INCOME:		
Gain (loss) on derivatives	<u>73,703</u>	<u>(56,360)</u>
COMPREHENSIVE INCOME (LOSS)	<u>\$ 1,491,298</u>	<u>\$ (47,308,632)</u>

See notes to consolidated financial statements.

NAC International Inc.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)
YEARS ENDED DECEMBER 31, 2003 AND 2002

	Class A		Class B		Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Deficit)	Treasury Stock		Total
	Common Stock		Common Stock					Shares	Amount	
	Shares	Amount	Shares	Amount						
BALANCE—December 31, 2001	5,152,028	\$ 51,521	300,833	\$ 3,008	\$ 12,742,751	\$ (89,214)	\$ (13,306,513)	20,527	\$ (34,812)	\$ (633,259)
Issuance of common stock	7,500,000	75,000								75,000
Retirement of treasury stock	(20,527)	(205)			(34,607)			(20,527)	34,812	
Net loss on derivatives						(56,360)				(56,360)
Net loss							(47,252,272)			(47,252,272)
BALANCE—December 31, 2002	12,631,501	126,316	300,833	3,008	12,708,144	(145,574)	(60,558,785)			(47,866,891)
Issuance of common stock	1,041,083,200	10,410,832								10,410,832
Net gains on derivatives						73,703				73,703
Net income							1,417,595			1,417,595
BALANCE—December 31, 2003	1,053,714,701	\$ 10,537,148	300,833	\$ 3,008	\$ 12,708,144	\$ (71,871)	\$ (59,141,190)		\$	\$ (35,964,761)

See notes to consolidated financial statements.

NAC International Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2003 AND 2002

	2003	2002
OPERATING ACTIVITIES:		
Net income (loss)	\$ 1,417,595	\$(47,252,272)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,503,022	2,679,701
Write-off of equipment		1,767,953
Loss on disposal of equipment	301,025	
Changes in operating assets and liabilities:		
Accounts receivable—trade and costs and profits in excess of billings	4,973,964	6,675,842
Advances to employees, income tax receivable, and other current assets	400,658	72,976
Other assets	1,309	46,456
Accounts payable, accrued expenses and other payables, and accrued income taxes	(5,014,913)	6,109,291
Deferred revenue	171,234	723,648
Provision for losses on contracts	(4,276,497)	2,011,997
Other long-term liabilities	(1,839)	439,016
Net cash provided by (used in) operating activities	<u>475,558</u>	<u>(26,725,392)</u>
INVESTING ACTIVITIES:		
Proceeds on disposal of equipment	7,948	
Purchases of property and equipment	(118,484)	(1,082,712)
Net cash (used in) investing activities	<u>(110,536)</u>	<u>(1,082,712)</u>
FINANCING ACTIVITIES:		
Issuance of common stock		75,000
Payments on operating line of credit		(3,157,000)
Proceeds from nonrevolving operating line of credit	4,000,000	35,000,000
Principal payments on term note payable	(1,000,000)	(800,000)
Principal payments on capital lease obligations	(444,309)	(477,337)
Net cash provided by financing activities	<u>2,555,691</u>	<u>30,640,663</u>
INCREASE IN CASH	2,920,713	2,832,559
CASH AT BEGINNING OF YEAR	<u>2,946,179</u>	<u>113,620</u>
CASH AT END OF YEAR	<u>\$ 5,866,892</u>	<u>\$ 2,946,179</u>

SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES—

Capital lease obligations totaling \$0 and \$946,886 were incurred in 2003 and 2002, respectively, when the Company entered into leases for new equipment. Interest paid totaled \$233,485 and \$561,014 in 2003 and 2002, respectively. Income taxes paid totalled \$206,527 and \$39,236 in 2003 and 2002, respectively. In 2003, the Company received \$278,652 in refunds of income taxes. During 2003, \$10,410,832 of common stock was issued at par value of \$.01 in exchange for release from obligations to Pinnacle West for settlement payments to a customer. See Note 12.

See notes to consolidated financial statements.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2003 AND 2002**

1. NATURE OF OPERATIONS

NAC Holding, Inc. and subsidiary's (the "Company") revenues are derived from a variety of products and services related primarily to the nuclear energy industry. The Company generates revenue from three primary business units: consulting, engineering and design services, and site and transportation services. The consulting unit provides nuclear energy industry expertise to both government agencies and commercial businesses on a project basis, including services associated with the Nuclear Materials Management and Safeguards System database, which monitors nuclear material transfers and inventories for the United States Department of Energy ("DOE") and the United States Nuclear Regulatory Commission. The engineering and design services unit develops, markets, and contracts for the manufacture of spent nuclear fuel storage and transportation cask designs. The site and transportation services unit provides irradiated nuclear fuel handling and transportation services, both domestic and internationally. The Company provides these services to a variety of customers including federal and foreign government agencies, domestic and foreign utilities, and others. The source of the Company's revenues varies among its business units as new projects are obtained periodically. The Company maintains its principal offices in the United States of America, with satellite offices in England, Japan, and Russia. The Company regularly performs services for customers located outside of these countries. Substantially all the Company's assets, other than receivables due from certain foreign entities, are employed within the United States of America.

The Company is 99.8% owned by El Dorado Investment Company ("EDIC"), which is a wholly owned subsidiary of Pinnacle West Capital Corporation ("Pinnacle West"). Pinnacle West has multiple subsidiaries and is one of the leading generators of electricity in the western United States of America and operates one of the largest nuclear reactor power generation plants in the United States of America. Through its subsidiary, EDIC, Pinnacle West began investing in the Company in 1983 as a strategic entrance into the energy and nuclear spent fuel dry storage market.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation—The financial statements include the accounts of NAC International Inc., a wholly owned subsidiary of NAC Holding, Inc. All significant intercompany transactions have been eliminated.

Reclassifications—Certain amounts in the prior years' financial statements have been reclassified to conform to the current year's presentation.

Revenue and Cost Recognition—Contract revenues are accounted for under the percentage-of-completion method.

Revenues are recognized based upon total costs incurred to date compared to total costs expected to be incurred for each contract. Revisions in contract revenue and cost estimates are reflected in the accounting period when known. Provisions are made for the full amounts of anticipated losses in the periods in which they are first determined. Changes in job performance, job conditions, and estimated profitability, including those arising from contract penalty provisions, and final contract settlements may result in revisions to costs and income and are recognized in the period in which revisions are determined. Profit incentives are included in revenues when their realization is reasonably assured.

NAC International Inc.

Cost estimates require significant judgment and estimation. Uncertainties with respect to such judgment and estimates are inherent in the preparation of financial statements in conformity with accounting principles generally accepted in the United States. Actual results could differ significantly from those estimates.

Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs, and depreciation costs. General and administrative costs are charged to expense as incurred.

Costs and profits in excess of billings on uncompleted contracts projects represent revenues recognized in excess of amounts billed. Deferred revenue represents billings in excess of revenues recognized.

Accounts billed but not paid pursuant to retainage provisions under construction contracts generally become due upon completion of the contracts and acceptance by the customer. In accordance with industry practice, the Company includes amounts realizable and payable under long-term construction contracts in current assets and liabilities.

Cash Equivalents—Marketable securities that are highly liquid and have maturities of three months or less at the date of purchase are classified as cash equivalents.

Accounts Receivable—The Company provides an allowance for its estimate of uncollectible accounts receivable. The Company generally does not require collateral or other security for its receivables. Historically, the Company has not experienced any substantial uncollectible accounts receivable. However, the Company wrote off \$245,800 in receivables in 2002 related to a terminated contract. The Company wrote off \$80,797 of accounts receivables in 2003.

Property and Equipment—Property and equipment are stated at cost. Spent fuel casks and mobile service equipment include expenditures for equipment, regulatory licensing and testing, and subsequent qualification requirements of regulatory agencies. Expenditures for renewals and improvements are included in the property accounts; however, replacements and maintenance and repairs, which do not extend the life of assets, are expensed as incurred. Provision for depreciation of assets and amortization of spent fuel cask licenses are computed, generally, on the straight-line method based upon the estimated useful service lives of the assets, which is generally five years. Provisions for amortization of leasehold improvements are computed on the straight-line method over the shorter of their useful life or the terms of the leases. Provisions for amortization of assets recorded under capital leases are included in the depreciation and amortization charge on the consolidated statements of operations.

Foreign Operations—Assets and liabilities of foreign operations are translated from the local currency into U.S. dollars at the approximate rate of currency exchange at the end of the fiscal period.

Revenues and expenses are translated at average monthly exchange rates. Transaction gains and losses are included in the results of operations. Foreign accounts are not significant.

Income Taxes—The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards ("SFAS") No. 109, *Accounting for Income Taxes*. Under SFAS No. 109, the liability method is used in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and the income tax bases of assets and liabilities and are measured using the enacted tax rate and laws that are anticipated to be in effect when the differences are expected to reverse.

NAC International Inc.

Stock-Based Compensation—The Company has elected to follow Accounting Principles Board (“APB”) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations in accounting for its employee stock options. Under APB Opinion No. 25, no compensation expense is recognized because the exercise price of the Company’s employee stock options equals the market price of the underlying stock on the date of grant. SFAS No. 123, *Accounting for Stock-Based Compensation*, requires that companies electing to continue using the intrinsic value method make pro forma disclosures of net income as if the fair value-based method of accounting had been applied. The effect of amortizing the fair value of the options granted on the Company’s pro forma net income for 2003 and 2002 is not material.

Research and Development Costs—Research and development costs are expensed as incurred by the Company.

Use of Estimates—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, the disclosure of contingent assets and liabilities as the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Adjustments made to the Company’s consolidated financial statements with respect to certain estimates often relate to information not previously available. Uncertainties with respect to such estimates are inherent in the preparation of financial statements. Actual results could be different from those estimates.

Loss Contingencies—The Company accounts for loss contingencies in accordance with SFAS No. 5, *Accounting for Contingencies*. Accordingly, loss contingencies are accrued for by a charge to income if information prior to the issuance of the consolidated financial statements indicates that it is probable that a liability had been incurred at the date of the consolidated financial statements, and the liability can be reasonably estimated.

Long-Lived Assets—Effective January 1, 2002, the Company adopted SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. This statement requires a three-step approach for assessing and recognizing the impairment of long-lived assets including: (1) consider whether indicators of impairment of long-lived assets are present; (2) if indicators of impairment are present, determine whether the sum of the estimated undiscounted future cash flows attributable to the assets in question is less than their carrying amount; and (3) if less, recognize an impairment loss based on the excess of the carrying amounts of the assets over their respective fair values. The adoption of SFAS No. 144 did not have a material effect on the Company’s consolidated financial statements.

Derivatives—The Company accounts for derivatives under SFAS No. 133, as amended by SFAS No. 137, No. 138, and No. 149, *Accounting for Derivative Instruments and Hedging Activities*. SFAS No. 133 requires the Company to recognize all derivatives on the balance sheet at fair value. For derivatives designated as hedges, the change in the fair value of the derivative is offset against the change in the fair value of the hedged asset, liability, or firm commitment through earnings or recognized in other comprehensive income (loss) until the hedged item is recognized in earnings. Derivatives that are not hedges must be adjusted to fair value through income.

As of December 31, 2003, the Company had one interest rate swap agreement. The interest rate swap has been designated and qualifies under the provisions of SFAS No. 133 as a cash flow hedge. By matching the terms of the interest rate swap agreement and its designated debt instrument, the Company has structured a cash flow hedge that is highly effective in offsetting the variable interest cash flows on the related debt instrument. The Company monitors hedge effectiveness and the financial standing of the counter-party on an ongoing basis. The fluctuation in the fair value of the interest rate swap is included

NAC International Inc.

in other comprehensive loss, a component of stockholders' equity (deficit), and accrued expenses and other payables. For 2003, the Company has recognized a cumulative derivative liability and a corresponding amount in accumulated other comprehensive income of \$71,871. If in the future, the interest rate protection agreement was terminated or in the event of early extinguishment of the designated debt obligation, the fair value of the cash flow hedge would be recognized as an expense.

Goodwill—In July 1997, the Company acquired certain assets of The S.M. Stoller Corporation, a nuclear fuel-consulting firm to the electric utility industry, for approximately \$429,000. The acquisition was recorded using the purchase method of accounting. The identifiable assets of the acquired business have been recorded at estimated fair value. Approximately \$418,000 was recorded as goodwill. The results of operations related to the acquisition are included in the Company's consolidated statements of operations since the acquisition date.

Effective January 1, 2002, the Company adopted SFAS No. 142, *Goodwill and Other Intangible Assets*. As a result, goodwill is no longer amortized. The adoption of SFAS No. 142 required an initial impairment assessment involving a comparison of the fair value of goodwill to the current carrying value. Upon adoption, the Company recorded no loss as the fair value of goodwill exceeded the current carrying value. The Company performs tests for impairment of goodwill annually or more frequently if events or circumstances indicate it might be impaired. Such tests include comparing the fair value of the reporting unit with its carrying value, including goodwill. Impairment assessments are performed using cash flow analyses.

3. GOING CONCERN ASSUMPTION

These consolidated financial statements have been prepared on a going concern basis, which assumes that the Company will be able to meet its commitments, realize its assets, and discharge its liabilities in the normal course of business for the foreseeable future.

During 2001 and 2002, the Company incurred significant losses, primarily due to the contractual terms and performance of three long-term contracts. During 2003, one of the three projects has been terminated for convenience and its results fully recorded as of December 31, 2002 (see Note 12). One other contract was renegotiated, allowing the Company to earn an additional \$2,000,000, while completing the contract during 2003. The third contract is near completion and management believes that it will be completed within the cost estimates provided for at December 31, 2003.

During 2003, the Company took steps to reduce its cost structure by consolidating functional areas and personnel, eliminating redundancies and streamlining facility costs, and continuously evaluating areas of cost savings. Additionally, the Company implemented a more rigorous project review process, more structured procurement practices, and contractual terms and conditions policies to facilitate future profitability. The Company also replaced key senior management positions with individuals with significant experience in the areas of contract, project, and business management. Operating results for the year ended December 31, 2003 were operating income of \$4,028,688 and net income of \$1,417,595. Management believes that these actions and continued steps that it plans to initiate will serve to sustain the Company's return to profitable operations and generate positive cash flows.

The Company has a working capital deficiency of \$40,491,519 and total stockholders' deficit of \$35,964,761 as of December 31, 2003. The Company sustained its operations during 2001 and 2002 with the use of a nonrevolving line of credit in the form of a Convertible Promissory Note ("Note") executed with its majority shareholder, El Dorado Investment Company ("EDIC") (see Note 11). As of December 31, 2003, the principal amount owed by the Company on the Note is \$39,000,000.

NAC International Inc.

The Note matures June 26, 2004, when all amounts owed, including interest, are due and payable. The Company's ability to continue its operations on a going concern basis will depend on its ability to renegotiate and extend the repayment date for this Note or convert the Note to equity. The accompanying consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

4. PROPERTY AND EQUIPMENT

Property and equipment are composed of the following at December 31:

	2003	2002
Spent fuel transportation casks	\$ 1,522,654	\$ 1,522,654
Legal weight spent fuel transportation casks	11,620,463	11,548,154
Mobile service equipment	4,721,249	4,736,008
Office equipment	163,264	594,181
Computer systems and equipment	2,181,993	3,401,869
Leasehold improvements	259,968	535,195
	<u>20,469,591</u>	<u>22,338,061</u>
Less accumulated depreciation and amortization	<u>15,065,899</u>	<u>14,020,246</u>
	<u>\$ 5,403,692</u>	<u>\$ 8,317,815</u>

5. CREDIT FACILITIES

The Company had a revolving line of credit under a loan agreement ("Loan Agreement"), which expired on June 30, 2002, for the lesser of \$5 million or 85% of accounts receivable, as defined. The line of credit was collateralized by real and personal property including accounts receivable and other items and accrued interest at the base rate, as defined, or LIBOR plus 1.75% per annum.

On March 8, 2002, the Company entered into an Amended and Restated Loan Agreement ("Amended and Restated Loan Agreement") with the Company's bank, which expired on March 3, 2003. Under the Amended and Restated Loan Agreement, the Company could borrow amounts up to \$10,000,000. The Company was required to pay interest each month at the current prime lending rate, or LIBOR plus 1.7596, as defined in the agreement.

Also on March 8, 2002, as amended on March 25, 2002, Pinnacle West Capital Corporation ("Pinnacle West") entered into an Amended and Restated Guaranty Agreement, ("Amended and Restated Guaranty Agreement") with the Company's bank whereby Pinnacle West agreed to guaranty the Company's obligations under the Amended and Restated Loan Agreement up to a maximum amount of \$7,500,000. In the event the bank's lending commitment to the Company is reduced below \$10,000,000 (as defined in the Amended and Restated Loan Agreement), Pinnacle West's guaranty was to be reduced.

On June 26, 2002, the Company entered into an agreement with the Company's bank to change the expiration date on the Amended and Restated Loan Agreement from March 3, 2003 to August 26, 2002. Also on June 26, 2002, the Company entered into a Conditional Assignment and Patent Security Agreement with the Company's bank as additional security for amounts owed to the bank under the Amended and Restated Loan Agreement and the Term Note. All amounts outstanding on the Amended and Restated Loan Agreement were paid as of the expiration date, and no amounts are outstanding as of December 31, 2003 and 2002.

NAC International Inc.

The Company also had a line of credit under a construction loan agreement for an aggregate principal amount of up to \$4 million with a bank, which expired March 31, 2001. The proceeds of borrowings under this line were used solely for the purpose of designing and manufacturing transportation casks. The line of credit was collateralized by real and personal property, including accounts receivable, transportation casks, and other items and accrued interest at LIBOR plus 1.75%. These loans were converted by the Company into a term note ("Term Note"), payable in 20 equal quarterly installments beginning March 31, 2001 with a final maturity date of December 31, 2005. There was \$1.6 million outstanding under this Term Note payable at December 31, 2003 and \$2.6 million outstanding under the Term Note payable at December 31, 2002. The interest rate was 2.870% and 3.125% as of December 31, 2003 and 2002, respectively.

On March 30, 2001, the Company entered into an interest rate swap agreement with a bank with an initial notional swap amount of \$4 million that converts the Company's variable interest payments on the Term note payable to fixed interest payments by effectively fixing the underlying LIBOR rate at 5.65% plus 1.75%. This swap has been designated and qualifies under the provisions of SFAS No. 133 as a cash flow hedge, and the Company has determined that it is highly effective in offsetting the variable interest cash flows on the related debt instrument. The fluctuation in the fair value of the interest rate swap is included in other comprehensive loss, a component of stockholders' equity (deficit), and accrued expenses and other payables. At December 31, 2003, the carrying value of the swap approximated the fair value of \$71,871.

The fair value of the Company's Term note payable and capital lease obligations approximates their carrying values as of December 31, 2003 and 2002. The fair value of the \$39 million line of credit due to EDIC is not determinable due to the related-party nature of the debt. See Note 11 regarding this convertible promissory note with EDIC.

6. LEASES

The Company leases equipment under capital lease agreements. The net book value of assets recorded under all capital leases was \$19,963 and \$ 771,121 at December 31, 2003 and 2002, respectively. Amortization expense of assets recorded under capital leases is included in depreciation and amortization expense. Operating leases consist primarily of the Company's office space. Aggregate rental expense amounted to \$2,115,032 in 2003 and \$2,410,116 in 2002. Future minimum lease payments under noncancelable operating and capital leases were as follows at December 31, 2003:

	Noncancelable Operating Leases	Capital Leases
2004	\$ 1,709,563	\$ 107,439
2005	1,709,677	
2006	1,535,955	
2007	1,512,330	
2008	1,542,614	
After 2008	5,296,344	
Less interest		(1,788)
Total minimum lease payments	<u>\$13,306,483</u>	<u>\$ 105,651</u>

7. STOCKHOLDERS' EQUITY AND STOCK OPTIONS

Stock Purchase Warrants for Class A Common Stock—On March 8, 2002, the Company issued a Stock Purchase Warrant to Pinnacle West. This agreement was executed pursuant to a Guaranty Agreement, dated March 8, 2002 and amended March 25, 2002, and a Reimbursement Agreement, dated March 8, 2002 (see Note 11).

Under the Stock Purchase Warrant, Pinnacle West has the right to purchase common stock of the Company at an exercise price of the lesser of the net book value per share of the Company as of December 31, 2001 or \$2.50 per share until March 8, 2007. Because net book value was negative at December 31, 2001, the exercise price is at par value, or \$.01. The number of shares purchasable by Pinnacle West is 50% of the Guaranty Amount, as defined in the Guarantee Agreement, dated March 8, 2002, divided by the exercise price, subject to adjustments as defined in the Warrant related to changes in capitalization or a reorganization of the Company. As defined, Pinnacle West is allowed to purchase 375,000,000 shares of Class A common stock.

On August 19, 2002, EDIC, a wholly owned subsidiary of Pinnacle West, executed a Warrant Transfer Agreement with Pinnacle West and subsequently exercised stock purchase warrants to purchase 7,500,000 shares of NAC Holding, Inc. Class A common stock for \$75,000.

Reimbursement and Indemnity Agreement—On May 30, 2003, pursuant to a Reimbursement and Indemnity Agreement dated April 22, 2003, EDIC, as assignee from Pinnacle West, characterized the Maine Yankee Payment (see Note 12) as equity. Under the agreement, EDIC acquired an additional 1,041,083,200 shares of NAC Holding, Inc. Class A common stock for \$10,410,832.

Minority Shareholder Transaction—On January 23, 2003, Citicorp Venture Capital, Ltd. sold 100% of its ownership in the Company, which consisted of 1,686,522 shares, to a private individual.

Stock Option Plan for Class B Common Stock—The Long-Term Incentive Stock Option Plan, as approved by the Board of Directors, authorizes the grant of options for up to 550,000 shares of Class B common stock to key personnel for the purchase of the Company's Class B common stock at prices not less than the fair market value of the shares on the date of grant. The options vest over five years and must be exercised within ten years from the date of the grant.

During 1997 and 1998, 450,000 and 60,000 shares were granted, respectively. Of the shares granted, 300,833 have been exercised and 67,167 shares were cancelled due to employee termination. All of the remaining grants are fully vested as of December 31, 2003. The exercisable grants expire in 2007 and 2008.

The Class B common stockholders do not have voting rights, and in the event of voluntary or involuntary liquidation of the Company under Chapter 7 of Title 11 of the United States Code, Class B common stockholders receive secondary preference to the Class A common stockholders.

At December 31, 2003 and 2002, the Company had reserved 142,000 shares of Class B common stock in connection with shares issuable upon exercise of stock options. The fair value of the stock options granted under this plan is immaterial and the pro forma effects on net income (loss) of accounting for such stock options using the fair value method of accounting is also immaterial.

NAC International Inc.

A summary of the Company's Class B common stock option activity is as follows:

	Shares	Weighted Average Exercise Price
Outstanding—December 31, 2002	<u>182,000</u>	\$ 0.15
Cancelled due to terminations—2003	<u>(40,000)</u>	0.15
Outstanding—December 31, 2003	<u>142,000</u>	0.15
Exercisable—December 31, 2003	<u>142,000</u>	0.15
Shares available for future grants	<u>107,167</u>	

8. INCOME TAXES

In 2003, the Company amended its federal income tax returns for the years 1999 through 2001 and utilized federal net operating loss carrybacks of \$4,250,000 and net operating loss carryforwards of \$1,893,134 in order to reduce taxable income for 1999 and 2000.

The Company filed a federal income tax return for the short period ended August 31, 2002 and was consolidated into its ultimate parent company, Pinnacle West's, federal income tax return for the short period ended December 31, 2002. Subsequent to August 31, 2002, income taxes are allocated to the Company based on a separate return methodology.

The components of federal and state income tax expense (benefit) are:

	2003	2002
Current	\$ 48,823	\$
Deferred	<u> </u>	<u> </u>
	<u>\$ 48,823</u>	<u>\$</u>

NAC International Inc.

The income tax provision for 2003 is the result of state income tax payments for prior years in jurisdictions which do not allow for carrybacks of net operating losses. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Deferred income tax assets were impacted during 2003 by a change in the effective tax rate as a result of consolidation of the Company for tax purposes with Pinnacle West. Significant components of the Company's deferred tax liabilities and assets are as follows as of December 31:

	2003	2002
Deferred tax assets:		
Net operating loss carryforwards—federal	\$ 16,017,861	\$ 14,967,075
Main Yankee termination payment		3,871,443
Section 59 R&D election	2,689,188	
Provision for losses on contracts	1,037,270	1,797,647
Net operating loss carryforwards—state	1,967,909	1,760,832
Book over tax depreciation	685,778	195,869
Interest rate swap	28,226	55,318
Other	669,320	24,945
Total deferred tax assets	23,095,552	22,673,129
Valuation allowance for deferred tax assets	(23,095,552)	(22,673,129)
Net deferred tax assets	<u>\$</u>	<u>\$</u>

The Company's federal net operating loss carryforward of approximately \$45.8 million expires in 2023. State net operating loss carryforwards of approximately \$ 46.3 million expire in 2005 through 2023.

For financial reporting purposes, a valuation allowance has been recorded at December 31, 2003 to reduce the deferred tax assets to \$0. The Company has provided the allowance as a result of management's evaluation that, based on the weight of available evidence, it is more likely than not that such deferred tax assets will not be realized.

9. RETIREMENT PLAN

The Company has a defined contribution retirement plan, which covers substantially all employees of the Company. The plan allows eligible participating employees to contribute up to 15% of their respective salary per pay period and receive a 100% matching contribution up to 5% of their contribution. The matching percentage is determined annually by the Company and was 5% in 2003 and 2002. The plan allows for additional unmatched voluntary contributions. The Company may also make an optional contribution. Such optional contributions are voluntary and made at the sole discretion of the Board of Directors. The Company made no optional contribution to the plan in 2003 and 2002. The matching contributions by the Company were \$421,618 and \$522,927 in 2003 and 2002, including administrative expenses, respectively.

10. MAJOR CUSTOMERS

A significant portion of the Company's revenues and cash flows are derived through contracts with various units of the federal government and three major customers.

NAC International Inc.

Revenues from customers exceeding 10% of total revenues for the year ended December 31, 2003 were as follows (as a percentage of consolidated revenues):

Customer	Percentage of Total Revenue
Federal government	14 %
A	23
B	20
C	13

Due to the completion of certain contracts for these customers, the percentages above are not indicative of the Company's future revenues and cash flows.

11. RELATED PARTY TRANSACTIONS

Effective August 2002, the Company is 99.8% owned by EDIC, which is a wholly owned subsidiary of Pinnacle West. Pinnacle West has multiple subsidiaries, is one of the leading generators of electricity in the western United States of America, and operates one of the largest nuclear reactor power generation plants in the United States of America. Through its subsidiary, EDIC, Pinnacle West began investing in the Company in 1983 as a strategic entrance into the energy and nuclear spent fuel dry storage market.

Between 1983 and 1997, EDIC increased its ownership in the Company to approximately 49%, while supporting certain research and development activities of the Company's dry storage systems. In 1998, EDIC and another minority shareholder invested additional funds for the Company's LWT fabrication and general working capital needs, increasing its ownership to approximately 55%, where it remained until 2002.

During the years 2001 and 2002, the Company experienced losses on certain long-term contracts, which resulted in EDIC and Pinnacle West entering into certain agreements with the Company, its customers, and its bank, while extending the Company additional funding. These agreements and other related party arrangements are discussed below.

Performance Guarantees—The Company and Pinnacle West entered into an agreement in 1999 whereby Pinnacle West provided a performance guarantee for two contracts. In exchange for the guarantee, the Company paid a 2% fee on the average monthly outstanding contract balances excluding fabrication costs. The fee is computed and paid semiannually over the life of each contract. In 2003 and 2002, the Company recorded expenses totaling approximately \$0 and \$9,000, respectively, and made payments of \$0 and \$9,000, respectively. This agreement was replaced by an amended and restated parent guarantee, dated April 22, 2003, whereby Pinnacle West guaranteed the performance of the Company in the amount of \$3,770,171. This amount is adjusted downward to the extent of the Company's performance progress. The amount remaining on the amended and restated parent guarantee as of December 31, 2003 was \$471,231 (see Note 12).

The Company and Pinnacle West entered into an agreement on February 20, 2003, whereby Pinnacle West guaranteed the performance and payments on a contract in the form of a \$5,400,000 letter of credit naming the Company's customer as the beneficiary. This letter of credit is reduced in amount as certain milestones are completed. In the event Pinnacle West pays any amounts under the letter of credit, the Company is obligated to reimburse Pinnacle West the full amount plus interest equal to the monthly LIBOR plus 3% per annum. As of December 31, 2003, the Company's performance under the contract has been completed and the letter of credit cancelled.

NAC International Inc.

In 2001, the Company, Pinnacle West, and the United States Fire Insurance Company ("Insurance Company") entered into an agreement to indemnify the Insurance Company from losses sustained by the Insurance Company when executing or procuring the execution of any performance bond. The Insurance Company furnishes performance bonds that guarantee the Company's performance on a contract or payment of subcontractors and or creditors. The liability of Pinnacle West is limited to an aggregate amount of \$40,000,000.

Convertible Promissory Note—On June 26, 2002, the Company entered into the Note with EDIC, which expires June 26, 2004. Under the terms of the Note, which acts as a nonrevolving line of credit, the Company was able to borrow up to the principal amount of \$30,000,000. The Company is required to pay interest each month on the principal balance at a rate of LIBOR plus 4.75% per annum (6.16% at December 31, 2003). In the event of default, the Note accrues interest on the principal balance at a rate of LIBOR plus 7.75% per annum. The note may be converted, in whole or in part at any time, into the number of shares of the Company's Class A common stock as is obtained by dividing the outstanding principal balance and all accrued and unpaid interest as of the date of the conversion by \$0.01. Also, in connection with this transaction, the Company paid a \$300,000 administration fee.

On August 30, 2002, the Company and EDIC amended the Note by increasing the principal amount from \$30,000,000 to \$35,000,000. Also, the Company paid an additional \$50,000 administration fee.

On February 18, 2003, the Company and EDIC amended the Note by increasing the principal amount from \$35,000,000 to \$42,900,000. As of December 31, 2003 and 2002, the Company owed EDIC \$39,000,000 and \$35,000,000, respectively.

In 2003 and 2002, the Company recorded administration and interest expenses of \$0 and \$2,334,968 and \$350,000 and \$882,380, respectively. In 2003, the Company made administration and interest payments of \$0 and \$0, respectively. As of December 31, 2003 and 2002, the Company owed EDIC accrued interest of \$3,159,081 and \$824,838, respectively. On January 31, 2004, the Company paid EDIC \$3,159,081 in accrued interest.

Amended and Restated Loan Agreement and Amended and Restated Guaranty Agreement—On March 8, 2002, the Company entered into an Amended and Restated Loan Agreement with the Company's bank, which was to expire on March 3, 2003. Under the Amended and Restated Loan Agreement, the Company may borrow amounts up to \$10,000,000. The Company is required to pay interest each month at the current prime lending rate or LIBOR plus 1.7596, as defined in the Amended and Restated Loan Agreement.

Also on March 8, 2002, as amended on March 25, 2002, Pinnacle West entered into an Amended and Restated Guaranty Agreement ("Amended and Restated Guaranty Agreement") with the Company's bank whereby Pinnacle West agreed to guaranty the Company's obligations under the Amended and Restated Loan Agreement up to a maximum amount of \$7,500,000 ("Guaranty Amount"). In the event the bank's lending commitment to the Company is reduced below \$10,000,000 (as defined in the Amended and Restated Guaranty Agreement), Pinnacle West's guaranty will be reduced.

On June 26, 2002, the Company entered into an agreement with the Company's bank to change the expiration date on the Amended and Restated Loan Agreement from March 3, 2003 to August 26, 2002. All amounts outstanding on this loan were paid as of the expiration date and no amounts are outstanding as of December 31, 2003 and 2002.

Reimbursement Agreements With Pinnacle West Capital Corporation—On March 8, 2002, the Company entered into a Reimbursement Agreement with Pinnacle West. The Reimbursement

NAC International Inc.

Agreement requires the Company to immediately reimburse Pinnacle West for any amounts paid by Pinnacle West to the bank under the Amended and Restated Guaranty Agreement. If the Company does not immediately repay Pinnacle West, the amounts due to Pinnacle West will accrue interest at LIBOR plus 5% per annum. The Company paid \$0 during 2003 and 2002 under the Reimbursement Agreement, and no amounts were due as of December 31, 2003 and 2002. Beginning April 1, 2002, the Company is required to pay Pinnacle West a guaranty fee on the first day of each month, in arrears, of the total Guaranty Amount at a rate of 1.25% per annum. The Company recorded expenses totaling approximately \$0 and \$43,000 in 2003 and 2002 and made payments of \$0 and \$43,000 to Pinnacle West in 2003 and 2002, respectively. As of December 31, 2003, there were no amounts borrowed by the Company under the Amended and Restated Guaranty Agreement.

On February 20, 2003, the Company entered into an additional reimbursement agreement ("2003 Reimbursement Agreement") with Pinnacle West, concurrent with Pinnacle West's execution of a \$5,402,029 performance and payment guarantee in the form of a letter of credit for a company contract. The 2003 Reimbursement Agreement requires the Company to immediately reimburse Pinnacle West for any amounts paid by Pinnacle West under the performance and payment guarantee of the letter of credit. If the Company does not immediately repay Pinnacle West, the amounts due will accrue interest at LIBOR plus 5% per annum. The Company paid \$0 during 2003 under the 2003 Reimbursement Agreement, and no amounts were due as of December 31, 2003.

On April 22, 2003, the Company entered into a Reimbursement and Indemnity Agreement ("Reimbursement and Indemnity Agreement") with Pinnacle West, concurrent with Pinnacle West's execution of a Termination and Mutual Release Agreement and Parent Guarantee ("Parent Guarantee") for a company contract. That agreement requires the Company to immediately reimburse Pinnacle West for any amounts paid by Pinnacle West under the Parent Guarantee. If the Company does not immediately repay Pinnacle West, the amounts due will accrue interest at LIBOR plus 5% per annum. The Company paid \$0 during 2003 under the Reimbursement and Indemnity Agreement, and no amounts were due as of December 31, 2003. Pursuant to the terms of this Reimbursement and Indemnity Agreement, EDIC, as assignee from Pinnacle West, characterized \$10,410,832 of payments made under the Termination and Mutual Release Agreement to 1,041,083,200 shares of Class A common stock of the Company (see Notes 7 and 12).

Stock Purchase Warrant Issued to Pinnacle West Capital Corporation—See Note 7 for discussion of a stock purchase warrant issued to Pinnacle West on March 8, 2002.

On August 19, 2002, EDIC, a wholly owned subsidiary of Pinnacle West, executed a Warrant Transfer Agreement with Pinnacle West and subsequently exercised stock purchase warrants to purchase 7,500,000 shares of NAC Holding, Inc. Class A common stock for \$75,000. As of December 31, 2003, EDIC holds 99.8% of the Class A common stock of the Company.

Security Agreements and Subordination and Consent Agreements—On June 26, 2002, the Company entered into a Security Agreement with EDIC whereby the Company grants to EDIC a security interest in and lien upon all property in order to secure the payment of all obligations of the Company to EDIC.

Also on June 26, 2002, the Company, EDIC, and the Company's bank entered into a Subordination and Consent Agreement whereby all obligations to EDIC are subordinated to the obligations owed to the Company's bank.

On February 20, 2003, the Company entered into a security agreement with Pinnacle West whereby the Company grants to Pinnacle West a security interest in and lien upon all property in order to secure the payment of all obligations of the Company to Pinnacle West. Also on February 20, 2003, as amended on

NAC International Inc.

April 22, 2003, the Company, Pinnacle West, and the Company's bank entered into a Subordination and Consent Agreement whereby all obligations to Pinnacle West are subordinated to the obligations owed to the Company's bank.

On February 20, 2003, the Company entered into a Conditional Assignment and Patent/Intellectual Property Security Agreement with Pinnacle West whereby the Company grants to Pinnacle West a security interest in patents, patent applications, trademark registrations, and other intellectual property in order to secure the payment of all obligations of the Company to Pinnacle West.

Arizona Public Service Company Royalty Agreement—The Company and Arizona Public Service Company ("APS"), a wholly owned subsidiary of Pinnacle West, entered into an agreement whereby in exchange for funding of approximately \$1 million in development costs, APS will receive: (1) certain royalty payments on casks sold by the Company, (2) one cask at no cost to APS, and (3) a 5% discount on the purchase of other casks. The Company has included anticipated royalty costs for 108 casks and the costs of one free cask in total contract costs as of December 31, 2002. The cost of one free cask included in total contract costs is approximately \$482,000. The Company has recorded \$487,000 in accrued expenses and other payables as of December 31, 2003 for royalty costs and paid \$825,000 and \$0 in 2003 and 2002, respectively.

Arizona Public Service Company Contract—In 1999, the Company entered into an agreement with APS to sell casks and to provide labor, supervision, and other services, as deemed necessary, for a total contract amount of \$19,105,992. As of December 31, 2003, the Company has recorded \$15,024,069 in revenues since the inception of the project. The Company is currently negotiating a contract extension with APS that would include 28 additional storage systems. The estimated contract value of the extension approximates \$16 million. As of December 31, 2003 and 2002, APS owed the Company \$3,350,699 and \$390,799, respectively.

Management Services Agreement—On June 24, 2002, the Company and Pinnacle West entered into a services agreement whereby Pinnacle West would provide certain business consulting and corporate services to the Company under the direction of the Company's Board of Directors. This agreement was initially effective through December 31, 2002 and, on December 19, 2002, was extended through December 31, 2003. In 2003 and 2002, the Company recorded expenses of \$114,195 and \$1,111,985 and made payments of \$932,737 and \$293,443, respectively. Under this agreement, as of December 31, 2003 and 2002, the Company owed Pinnacle West \$0 and \$818,542, respectively.

12. MAINE YANKEE SETTLEMENT AGREEMENT

On April 22, 2003, the Company and Maine Yankee Atomic Power Company ("Maine Yankee") terminated for convenience a purchase order dated November 30, 1998 to perform certain services in aid of the decommissioning of the Maine Yankee nuclear power facility. The termination is effective January 15, 2003. Also terminated were certain other related performance and payment agreements. Under the Termination and Mutual Release Agreement ("Agreement"), Pinnacle West paid Maine Yankee \$10,410,832 in full settlement of obligations ("Maine Yankee Payment") and Maine Yankee paid the Company \$722,825 for costs incurred by NAC during the period the settlement was being negotiated. These amounts were presented net as Settlement payment due to Pinnacle West and Operating costs as of and for the year ended December 31, 2002.

Also, the Company and Maine Yankee have executed two new agreements: (1) a fixed price agreement to finish certain fabrication scope of work under the original purchase order for \$3,770,171 and (2) a time and materials agreement for design, engineering, licensing, and quality assurance services on additional work. This time and materials agreement has no defined scope of work and the Company has

NAC International Inc.

no obligations until it agrees to a work order issued by Maine Yankee. Pinnacle West guarantees the performance of the fixed price agreement up to \$3,770,171, which decreases as payment is made by Maine Yankee to the Company. As of December 31, 2003, the amount remaining on the performance guarantee is \$471,231. As of March 15, 2004, all the equipment required to be fabricated under the scope of the fixed price agreement has been delivered to Maine Yankee.

Additionally, Pinnacle West has guaranteed payment to all subcontractors on this project through January 15, 2003. As of December 31, 2003, all subcontractors have been paid in full for service performed through January 15, 2003.

Additionally, the Company has granted a license to Maine Yankee to use certain equipment that is owned by the Company for the performance of additional work.

Upon completion of the additional work, Maine Yankee will return the equipment to the Company. Since the above time and materials agreement has no defined scope of work, and if the Company agrees to a work order and only consulting type services will be provided, the Company is receiving no revenue for this equipment. Also, the Company believes this equipment will no longer be used on future projects. In accordance with SFAS No. 144, the Company wrote off this equipment and recorded a charge to income for \$1,767,953 for the year ended December 31, 2002.

On May 30, 2003, EDIC, as assignee from Pinnacle West, made a contribution to capital of the "Settlement payment due to Pinnacle West" referred to above in exchange for 1,041,083,200 shares of Class A common stock.

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