EFJ, Incorporated
Initiating Coverage

(EFJI.BB – $4.50)

Speculative
BUY

- Currently listed on the OTC Bulletin Board, EFJ does qualify for Small Cap listing, and we believe the company is in the application process to achieve this over the next few months. Readers should be cognizant of Blue-Sky implications.

- EFJ is a holding company for two subsidiaries - 80-year-old EFJohnson, and 25-year-old Transcrypt International. EFJ has undergone major changes in management and personnel to give the company new direction. In November 2000, EFJ made the decision to focus on the domestic public safety/public service sector, de-emphasizing the commercial market and eliminating many of its commercial product offerings.

- There is a glaring need for interoperability for domestic public safety. The United States General Accounting Office has found that interoperability has been an on going problem for the federal government for the past 15 years. According to Public Safety Wireless Program (PSWN), over 1,500 public safety agencies responded to a survey and nearly one-third stated difficulty in responding to incidents due to a lack of wireless communications interoperability.

- EFJ’s strategy is to focus on Project 25 products and systems that are required for wireless communications interoperability for U.S. First Responders.

- Strengthening order activity and backlog has enabled increasing R&D spending. EFJ is opening an engineering facility in Dallas to support new RF product development. Also, EFJ is working to lessen its reliance on outsourced components, all of which will help support higher margins in the future.

- A licensing agreement with Motorola allows EFJ to sell its radios to end users that are compatible with Motorola’s network, which currently represents the vast majority of the market for installed land mobile radios (LMR). EFJI will not replace MOT in the LMR world, but it does provide an established second choice to the end users, one that is perhaps more responsive and flexible without the extra costs.

- EFJ’s primary market is the domestic installed LMR base. This market was approximately $18.3 billion in 1998. Since 1998, we believe both the size of the installed base market and the contribution from the federal government has increased. Currently, these markets are predominately analog based, but the momentum to move to digital will pick up in 2005 and beyond as legislation is limiting the manufacturing and the sale of such products in the future.

- Conventional APCO-25 portable/mobile radios are expected to grow 34.2% over the next five years to over $100 million annually, while the APCO-25 trunked radios are expected to grow at 51.4% to approximately $1 billion annually. From the infrastructure side, conventional APCO-25 systems are expected to grow 31.9% over the next five years to about $40 million per year, while the trunked APCO-25 systems are expected to be the market’s fastest growing sector at approximately 51% during this same time frame to about $1.3 billion per year. EFJ currently doesn’t offer APCO-25 trunked systems, but should by early 2005.

- EFJ appears attractively positioned with its “switchless” approach for Voice-over IP (VoIP). Whereas its competitors utilize switches in their VoIP systems, it appears that EFJ’s approach is less expensive to roll out, and easy to scale with growth.

- Customer contacts resonate high levels of satisfaction with EFJ’s products, service and overall management’s availability.

EFJ, Inc. is a manufacturer of wireless communications products and systems and information security products for the public safety/public service markets.
INVESTMENT RECOMMENDATION/VALUATION METHOD FOR SETTING PRICE TARGET

While not widely recognized, EFJ is hardly a new name. Its products are well established and management has re-focused EFJ’s opportunities so that revenue will be driven by spending within the public safety/public security marketplace. This strategy de-emphasized the corporate LMR market, as well as narrowed the product offering substantially. EFJ is not trying to be all things to all people.

We believe this narrowed focus has enabled the company to regain its reputation, cut operating expenses and improve margins. EFJ has turned profitable and this trend should become more obvious with the fourth quarter results. Backlog has increased to over $32 million.

EFJ is poised for strong revenue and earnings growth and we believe it is only a matter of time for its potential to be recognized.

We believe EFJ has completed its turnaround phase and is currently transitioning from being a portable unit supplier to again delivering systems. Prior to the re-organization, EFJ was focused on delivering P16 systems. While it does deliver conventional P25 systems today, it will deliver trunked systems by early 2005. Once this transition has occurred visibility should improve, as systems tend to be multi-year projects. Until then, EFJ may experience quarterly volatility as its business model is primarily driven by products and related funding. Despite this transition period, management has provided limited guidance.

We are initiating coverage with a Buy rating in speculative accounts and we are establishing a price target of $9. This valuation is based on 22.5x our 2005 EPS estimate of $0.40 (untaxed) and 1.8x our 2005 revenue estimate of $85.8 million. We believe these valuation metrics are on the conservative side, but we acknowledge the fact that switching from analog to digital in the public safety/public service sector is in its early phases. Dealing with governmental agencies can take longer than anticipated, from both a decision-making and funding standpoint.

COMPANY DESCRIPTION

EFJ is a manufacturer of wireless communications products and systems and information security products. EFJ, Inc. is the holding company to EFJohnson Company, one of the first developers of Project 25 mobile communications products compliant with federal government interoperability standards; and to Transcrypt International, a world leader in secure voice communication solutions.

The Company primarily sells its products to: domestic public safety/public service and other governmental users; domestic commercial users; and international customers.

EFJohnson Wireless Communications

EFJohnson (80-years old) designs, develops, manufactures, and markets: mobile (5300 series - digital software programmable - P25 compliant) and portable (5100 series - digital software programmable - P25 compliant) land mobile radios (LMR); stationary LMR transmitters/receivers (base stations or repeaters); and LMR systems.

In November 2000, the Company made the decision to focus on the domestic public safety/public service sector, de-emphasizing the commercial market and eliminating many of its commercial product offerings. Currently, EFJohnson represents about 85% of the Company’s revenues.
Transcrypt International’s Information Security

Transcrypt International (25-years old) designs and manufactures information security products, which prevent unauthorized access to sensitive voice communications. These products are based on a wide range of analog scrambling and digital encryption technologies and are sold mainly to the LMR markets as an add-on security device for analog radios.

During the turnaround period, this sector was not focused on. Management believes they have the majority of this market, estimated to be about $15 million annually. Indeed, this market has remained relatively flat over the past couple of years, but it does generate cash.

DOMESTIC PROBLEM: FAILURE TO COMMUNICATE

Public concern has grown for first responders and their inability to effectively communicate. Interoperable communication problems have existed for first responders and public safety agencies for many years mainly because many public safety agencies operate on different communication systems. This inability of our public safety officials to readily communicate threatens our safety. An example of this occurred on September 11th when a radio call helped all but 60 police officers escape from the tragic scene. Unfortunately, at least 121 firefighters lost their lives because they were totally unaware of the impending collapse. Since September 11th, the government and its agencies have made a large push to solve this communication problem.

There are five reasons why agencies have struggled to communicate with one another - incompatible and aging equipment, limited and fragmented funding, limited and fragmented planning, lack of coordination and cooperation, and a limited and fragmented radio spectrum. Each of these has led to the many pending problems public safety agents are dealing with everyday. An example of this is because each agency communicates on its own system, in some cases, law enforcement, firefighters, and emergency medical services (EMS) are forced to carry as many as five different radios. Many public safety agencies agree that there needs to be a solution to this ongoing problem that threatens both safety and people’s lives.

SOLUTION: INTEROPERABLE COMMUNICATION

The current solution to this communication problem is Project 25, which is a widely supported digital standard for wireless communication users enabling critical communication for the safety and security of people across the world.

While P25 does not require backward compatibility, EFJ designed their P25 products to be backward compatible with EFJ and Motorola proprietary P16 networks. This key differentiator allows EFJ’s Project 25 radios to work in both analog and digital mode.

Project 25 enables systems to be scalable from single channel conventional to regional trunking. To achieve bandwidth efficiency, Phase I of Project 25 mandates the move from 25 kHz to 12.5 kHz (doubling capacity). Phase II requires the move to 6.25 kHz, but the timing of this is uncertain.

Project 25 enables communications between neighboring systems, which is important for gathering aid from different resources. P25 has been coming together since 1989, but ran into a few obstacles in the 90's because of competitive issues between Motorola and Ericsson over which technology would best meet the needs of the public. Also adding to the mix was the turf wars between the agencies. But,
some experts believe this project should be coming to an end in the near future. Craig Jorgenson, project director for Project 25, said that the Project should be complete by 2004, if the industry can work out how to use spectrum more efficiently and bring digital technology into service.

This project is greatly supported by many public and private agencies including the International Association of Chiefs of Police, the International Association of Fire Chiefs, and the local, state, and federal public safety organizations.

**PLAYERS: DAVID’S AND GOLIATH**

Motorola is a modern day Goliath in the public safety communication sector representing about 90% of the entire market. Right behind Motorola is Tyco followed by EFJ. Motorola currently offers quality handsets and both digital and analog trunking systems, while EFJ offers quality handsets and a conventional system for digital use and a trunking system for analog use. The Company plans on releasing a digital trunking system by early 2005.

EFJ has a licensing contract with Motorola to sell their handsets that are compatible with Motorola’s network. EFJ sells their radios at approximately a 10-15% discount from Motorola.

EFJ plans on differentiating themselves from Motorola by being extremely flexible and focusing on servicing their clients. Motorola has several products that they offer but are not flexible within each model. EFJ has one product that they can customize to meet each of their clients’ needs.

There is a gradual move in the public sector from analog to digital that is slowly taking place at the federal, state, and local level.

From a product offering standpoint, Motorola is currently the leader in the P25 market, but EFJ is not far behind. EFJ currently offers conventional systems and handsets and soon will be releasing digital trunking systems that are P25 compatible.

EFJ’s radios are compatible on Motorola’s system and are much more scalable, offering the client more flexibility and control.

**OPPORTUNITY: A LARGE INSTALLED MARKET**

EFJ’s primary market is the existing domestic installed LMR base of approximately $18.3 billion that includes the federal (7%), state (9%), and local markets (84%). Currently, these markets are predominately analog based, but the momentum to move to digital will pick up in 2005 and beyond as legislation is limiting the manufacturing of new analog products and the ability to sell such products in the future.

Since September 11th, the federal government has given its support to spending on interoperable communication. EFJ has been named on contracts with several U.S. Government agencies. Specifically, EFJ has been named on the Department of Justice/Treasury for a $3.0 billion IDIQ; and on a $1.0 billion IDIQ with the Department of Interior.

In a study by IMS Research which covers the market to 2008, conventional APCO-25 portable/mobile radios are expected to grow 34.2% over the next five years to over $100 million, while the APCO-25 trunked radios are expected to grow at 51.4% to approximately $1 billion.

Looked at from an installed systems basis, conventional APCO-25 systems are expected to grow 31.9% over the next five years to approximately $40 million, while the trunked APCO-25 systems are expected to be the market’s fastest growing
sector at approximately 51% during this same time frame to approximately $1.3 billion. EFJ currently doesn’t offer APCO-25 trunked systems, but should by the end of 2004 or early 2005.

**EFJ’S PRODUCTS AND BUSINESS SEGMENTS SERVED**

**Wireless Communications**

EFJohnson’s radio offerings include both analog and digital radios. Its Project 25 radios, both hand-held portable and mobile radios, can contain voice scrambling and/or digital encryption technology, Over-the-Air-Reprogramming, and Project 25 trunking. Additionally, the Company’s Project 25 radios can be used on most Motorola APCO 16 systems because of a license agreement between the two companies.

EFJ sells both conventional and trunked systems that are compatible for either a digital or analog network. Conventional systems are single channeled and allow only one person to talk at a time, much like the old-fashioned “party line”. Trunked radio systems allow many users to share a limited number of radio channels by utilizing the first available channel. This allows multiple users to communicate together at the same time. Digital radios come equipped with a receiver and transmitter. They function by sending 1s and 0s through the air, which are then converted to analog to be played over the speaker. An analog radio sends and receives voice data through analog audio waves.

Within their current product mix, EFJ offers Voice-over IP (VoIP) functionality, which is where the market is heading, and could separate it from their competitors. VoIP is a way in which both voice and data are transferred within a conventional or trunked system. Rather than using a standard switch system, which makes a signal transfer from a handset to a repeater and then to a switch, a VoIP functional system can send voice or data from the handset to a repeater and then directly to another portable/mobile unit utilizing its IP address. While this is not always the key determinant with end user, the industry seems to be slowly moving towards VoIP as a standard form of voice and data transfer. EFJ’s VoIP is “switchless” compared to its competitors that still utilize switches in their VoIP configuration. We understand that Motorola does not currently offer a “switchless” VoIP solution to its customers, which could be a market differentiator for EFJ.

**Information Security**

Transcrypt first entered the information security market in 1978 with simple, transistor-based add-on scrambling modules for use in analog LMRs. Since that time, the Company has further developed and improved upon its core information security technologies.

Transcrypt’s current information security products are designed solely for the encryption of analog transmissions. As the LMR encryption customers migrate from analog to digital transmission systems, the overall market for analog encryption products may decrease. Due to the much higher cost of digital products, we believe the overall global demand for analog products will decrease at a fairly slow pace over the next few years. Additionally, there will be some parts of the world that will take many years to migrate to digital. In these regions, analog will still be used, and encryption products will be needed. Today, EFJ has about 10K systems encrypted worldwide in about 120 countries.

**EFJ’S COMPETITIVE ADVANTAGE**

The overall competitive advantage for EFJ strategy is to provide engineering and manufacturing flexibility and responsiveness. Motorola controls about 90% of the
overall market. In such a market, EFJ is capable of promoting itself as a “second source”. It certainly has brand recognition and its reputation has improved dramatically under the new management. EFJ also competes aggressively on price as its radios sell at about a 15% price discount to Motorola.

**Wireless Communications**

In most markets, Motorola and M/A-Com (owned by Tyco Int’l) are the leading providers of LMR equipment to the public safety/public service sectors. Other LMR providers include Thales Communications, Uniden America Corporation, Kenwood, ICOM America, Inc., Relm, Datron, Tait, and Midland.

**Information Security**

The markets for analog LMR information security products is highly proprietary, and management believes they have the majority of this market, estimated to be about $15 million annually. The proprietary nature of this market results in recurring revenue, as the customers are, in some respects, hooked. While growth is slow, it is switching more to an international market.

A number of companies currently offer add-on scramblers for LMRs that compete with EFJ’s add-on information security products, including Future Telecom (d.b.a. “Daxon”), Kavit Electronics Industries, Midian Electronics Inc., and MX-COM Inc.

**EFJ’s CUSTOMERS**

Significant customers accounting for more than 10% of revenues, as a combination of both wireless communications and encryption products, included: State of South Dakota, which represented approximately 12% of sales in both 2002 and 2001; Chester County of Pennsylvania, which represented approximately 14% of sales in 2001; and Motorola, which represented approximately 17% of sales in 2000. EFJ’s clients include federal agencies such as the Department of Justice, Department of Homeland Security, the Department of Commerce, the Department of Defense, the Department of Interior, and the Department of Transportation.

**Wireless Communications**

With its decision to de-emphasize the commercial market opportunities, sales to domestic commercial entities have steadily declined over the last two years. Comparatively, EFJ’s sales to domestic public safety/public service and other governmental agencies have increased, as evidenced by sales in the amount of $30.1 million in 2002, $26.9 million in 2001, and $20.9 million in 2000.

EFJohnson’s current LMR system sales are predominantly Multi-Net® systems. However, EFJohnson also offers Project 25 and LTR-Net® systems. The Multi-Net® and LTR-Net® product line incorporates the EFJohnson trunking protocols and includes: sub-audible signaling, which automatically selects a clear or unoccupied channel; open architecture that is compatible with other analog products; and transmission trunking, which provides efficient use of the channels.

**Information Security**

EFJI’s customers use information security products in a variety of situations involving differing security needs. The Company offers a variety of add-on LMR scrambling products featuring its core technologies at varying levels of security.
**MANAGEMENT**

**Mr. Michael Jalbert**, Chairman, President and CEO, was appointed to serve as a director upon his hiring as President and Chief Executive Officer on March 1, 1999. Mr. Jalbert was elected Chairman of the Board of Directors on March 25, 1999. Prior to joining EFJ, Inc., Mr. Jalbert served as President and Chief Executive Officer of Microdyne Corp., a Nasdaq listed company, from March 1997 to February 1999. From 1995 to 1997, Mr. Jalbert served as President and Chief Executive Officer of IDB Communications. From 1992 to 1995, Mr. Jalbert was President of the CSD division of Diversey Corporation. Mr. Jalbert joined the Diversey Corporation from West Chemical Corporation, where he was President and Chief Operating Officer from 1987 to 1992.

**Mr. Massoud Safavi** was appointed to serve as a director upon his hiring as Senior Vice President and Chief Financial Officer in October 1999. Prior to joining EFJ, Inc., Mr. Safavi served as Vice President and Chief Financial Officer of Xerox Engineering Systems Inc. beginning in May 1999. In addition, Mr. Safavi served as the Chief Financial Officer for Microdyne Corp. from June 1997 to March 1999. Prior to joining Microdyne Corp., Mr. Safavi spent nine years with UNC, Inc. where he served as Assistant Treasurer, division Chief Financial Officer, as well as the Director of Audit. Mr. Safavi is a C.P.A. and C.M.A.

**Mr. Dennis Blaine**, Executive Vice President, Sales & Marketing – EFJohnson, joined EFJ, Inc. in November 2000. Prior to joining the company, he was Vice President of business development for Advance Business Sciences, Inc. In addition, Mr. Blaine was Senior Vice President of global business development for SITEL Corporation. Mr. Blaine is a graduate of Purdue University.

**Mr. Kenneth Wasko**, Executive Vice President, Operations & Engineering - EF Johnson, joined the company in August 2002. Mr. Wasko worked for Motorola from 1987 until 2002 as the Director of Engineering, Director of Quality, Director of Operations, Worldwide Director of Engineering Quality and the General Manager of the Worldwide Accessories Division.

**Mr. Michael Kelley** is currently the General Manager of Transcrypt International. Before joining EFJ, Inc. in February 2002, he served over 4 years as Vice President of Sales at Riser Bond Instruments. Prior to this, he spent 21 years as an officer of a local snack food company and became Chairman of the Board of the International Snack Food Association his final year in the industry.

**THIRD QUARTER RESULTS**

**REVENUE:**

Revenues in the third quarter of 2003 were up 29% from $10.1 million in 2002 to $13.1 million. Much of this growth can be attributed to the 41% increase in the wireless communication segment, which comprised of $12.1 million of revenue. The information security segment had revenues of $1.1 million in the third quarter of 2003, which were down 33% compared to the previous year.

For the nine months, revenues were up 11% to $32.8 million compared to $29.5 million during the same period of 2002. The wireless communication segment was up 14% from a year ago to $28.1 million, while the information security segment was down $4.8 million.
$’s in Millions

<table>
<thead>
<tr>
<th></th>
<th>Q3 2003</th>
<th>Q3 2002</th>
<th>9-months 2003</th>
<th>9-months 2002</th>
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<td>Wireless Comm.</td>
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<td>$8.49</td>
<td>$28.14</td>
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<td>Info. Security</td>
<td>$ 1.10</td>
<td>$1.65</td>
<td>$4.66</td>
<td>$4.84</td>
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<tr>
<td>TOTAL</td>
<td>$13.09</td>
<td>$10.14</td>
<td>$32.80</td>
<td>$29.55</td>
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GROSS PROFIT:

Gross profit was $5.2 million with a 40% gross margin for the third quarter of 2003 compared to $4.3 million with a 43% gross margin for the same period in 2002. The wireless communication segment’s gross margin was 37% for the nine-month period compared to 39% a year ago. Gross Margin for the information security segment was 73% for the nine-month period compared to 70% a year ago.

OPERATING EXPENSES:

Operating expenses for the quarter were up to $7.0 million from $3.9 million a year ago. Operating expenses included non-cash compensation expense of $1.89 million in the quarter versus a benefit of $199K a year ago.

For the nine-month period operating expenses were up to $16.3 million from $12.3 million. Non-cash compensation expense for the period was $2.2 million compared with $162K a year ago.

G&A expense control has been a high priority and management has done a good job in this regard. R&D spending was spared from this scrutiny. R&D increased for new product development, which the new Dallas facility will be focused on. During its turnaround, management out-sourced components, and in some cases the suppliers were its competitors. Now, management would like to reduce this dependency and will bring design and control of some key components in house. This should enhance margins in the future.

EFJ repriced stock options During 2001 and 2000, the Company cancelled and reissued 620,000 and 366,000 stock options, respectively, under the Plan to lower the exercise price of those options to an amount approximately 150% of the prevailing market value of the Company’s common stock, or $0.656 per share. The repricing of the stock options resulted in a new measurement date for accounting purposes and the reclassification of these options as variable plan awards beginning on the date of the repricing. The compensation expense relating to these repriced options varies according to the market value of the Company’s common stock.

NET INCOME (LOSS):

EFJ reported a net loss for the quarter of $1.8 million or $0.10 per share compared with a gain of $491K or $0.03 per share. Excluding the non-cash charges for repriced options, a gain of $0.01 per share was reported versus a gain of $0.02 per share last year.

For the nine months, the net loss was $2.5 million or $0.14 per share compared with a gain of $784K or $0.04 per share. Excluding the non-cash charges for repriced options, the net loss was $0.02 versus a gain of $0.06 per share.

FINANCIAL STRENGTH:

EFJ had $2.3 million in cash at the end of the quarter and $578K in debt. Cash usage for operations during the nine months was $3.6 million. Since non-cash charges approximated the net loss, the cash usage was primarily for working capital.
purposes. Inventory increased $1.8 million in the anticipation of higher fourth quarter sales; and accounts receivable increased $1.4 million reflecting an increase level of sales occurring late in the quarter.

Shareholders’ equity was $32.2 million ($25.4 million tangible) or $1.85 per share ($1.44 tangible).

RISKS THAT TARGET PRICE MAY NOT BE ACHIEVED

- EFJ’s operating results historically fluctuate from period to period.
- EFJ’s sales are substantially concentrated in public sector markets that inherently possess additional risks that could harm revenues and gross margins.
- EFJ’s sales to foreign customers are subject to various export regulations; and the inability to obtain, or the delay in obtaining, any required export approvals would harm revenues.

The Company faces competitive pressures that could adversely affect revenues, gross margins, and profitability.

- If the APCO Project 25 standard is supplanted by some other recommended protocol or is otherwise not supported by the federal, state and local government agencies, it would adversely affect the Company’s operations, cash flows, and financial condition.
- A reduction in Motorola’s provision of products, components, or technology to the Company could harm the Company’s business and operations.
- If EFJ does not effectively manage the transition from analog to digital products, its revenues would be adversely affected.
- EFJ’s future success will depend upon its ability and the resources available to respond to the rapidly evolving technology and customer requirements in the markets in which it operates.
- The Company’s revenues are dependent upon the Company’s continued ability to enforce or license intellectual property rights.
- The foregoing list is not exhaustive. Other specific fundamental risks relating to EFJ, Inc. operations can be found in the company’s various 10K and 10Q filings.

Companies referenced:
Sitel Corporation (SWW - $2.61 – Not Rated)
Tyco Int’l (TYC - $23.90 - Not rated)
Ericson (ERICY - $17.76 – Not Rated)
Motorola (MOT - $13.37 – Not rated)

Analyst Certification

I, Richard Ryan, certify that the views expressed in this research report accurately reflect my personal views about the subject company and its securities. I also certify that I have not been, am not, and will not receive direct or indirect compensation related to the specific recommendations expressed in this report.
# EFJ, INC.

## Balance Sheet as of FY Dec-02 3Q 03

### Assets

<table>
<thead>
<tr>
<th>Current Assets:</th>
<th>FY Dec-02</th>
<th>3Q 03</th>
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<tbody>
<tr>
<td>Cash and cash equivalents</td>
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<td>Accounts receivable, net</td>
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<td>Receivables, other</td>
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<td>146</td>
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<tr>
<td>Cost in excess of billings on uncompleted contracts</td>
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<td>Inventories, net</td>
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<tr>
<td>Deferred income taxes</td>
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<td>Prepaid expenses</td>
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<td><strong>Total Current Assets</strong></td>
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<td>Property, plant and equipment</td>
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<td>Deferred income taxes</td>
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<tr>
<td>Intangible assets, net of accumulated amortization</td>
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<tr>
<td>Other assets</td>
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<td>691</td>
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<td><strong>TOTAL ASSETS</strong></td>
<td>$45,256</td>
<td>$41,053</td>
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### Liabilities and Stockholder's Equity

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<th>Current Liabilities:</th>
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<th>3Q 03</th>
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<tbody>
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<td>Revolving line of credit</td>
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<tr>
<td>Current portion of long-term debt obligations</td>
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<tr>
<td>Accounts payable</td>
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<tr>
<td>Billings in excess of cost on uncompleted contracts</td>
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<td>12</td>
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<tr>
<td>Deferred revenue - current</td>
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<tr>
<td>Accrued expenses</td>
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<td><strong>Total current liabilities</strong></td>
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<td>Long-term debt obligations, net of current portion</td>
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<td>449</td>
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<td>Deferred revenue, net of current portion</td>
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<td>196</td>
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<td><strong>TOTAL LIABILITIES</strong></td>
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<td>$8,868</td>
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### Stockholder's equity:

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<th>Stockholder's equity:</th>
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<th>3Q 03</th>
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<tr>
<td>Pfd. stock ($0.01 par value; 3,000,000 shares auth.)</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Common Stock ($0.01 par value; 25,000,000 voting shares authorized, 17,359,773 issued and outstanding as of June 30, 2003 and December 31, 2002; 600,000 non-voting shares authorized, 217,542 issued and</td>
<td>176</td>
<td>176</td>
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<tr>
<td>Additional paid-in capital</td>
<td>96,918</td>
<td>99,099</td>
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<tr>
<td>Accumulated deficit</td>
<td>(64,607)</td>
<td>(67,090)</td>
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<tr>
<td><strong>TOTAL STOCKHOLDER'S EQUITY</strong></td>
<td>$32,487</td>
<td>$32,185</td>
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<tr>
<td><strong>TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY</strong></td>
<td>$45,256</td>
<td>$41,053</td>
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### EFJ, INC.

**Fiscal Year ends Dec**

(In thousands)

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<tr>
<td><strong>Revenue</strong></td>
<td>$42,192</td>
<td>$44,168</td>
<td>$40,786</td>
<td>$9,001</td>
<td>$10,723</td>
<td>$13,089</td>
<td>$17,100</td>
<td>$49,913</td>
<td>$17,450</td>
<td>$17,950</td>
<td>$17,450</td>
<td>$16,950</td>
<td>$70,000</td>
<td>$85,750</td>
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<tr>
<td><strong>Cost of Revenue</strong></td>
<td>$34,063</td>
<td>$26,610</td>
<td>$23,216</td>
<td>5,042</td>
<td>6,079</td>
<td>7,853</td>
<td>9,642</td>
<td>28,616</td>
<td>10,101</td>
<td>10,389</td>
<td>10,092</td>
<td>9,779</td>
<td>40,360</td>
<td>49,165</td>
</tr>
<tr>
<td><strong>Gross Profit</strong></td>
<td>8,129</td>
<td>17,558</td>
<td>17,571</td>
<td>3,959</td>
<td>4,644</td>
<td>5,236</td>
<td>7,458</td>
<td>21,297</td>
<td>7,350</td>
<td>7,562</td>
<td>7,358</td>
<td>7,172</td>
<td>29,441</td>
<td>36,585</td>
</tr>
<tr>
<td><strong>Gross Margin</strong></td>
<td>19.3%</td>
<td>39.8%</td>
<td>43.1%</td>
<td>44.0%</td>
<td>43.3%</td>
<td>40.0%</td>
<td>43.6%</td>
<td>42.7%</td>
<td>42.1%</td>
<td>42.1%</td>
<td>42.2%</td>
<td>42.3%</td>
<td>42.1%</td>
<td>42.7%</td>
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<tr>
<td><strong>Research and development</strong></td>
<td>$5,763</td>
<td>4,972</td>
<td>4,573</td>
<td>1,402</td>
<td>1,813</td>
<td>1,939</td>
<td>1,950</td>
<td>7,104</td>
<td>679</td>
<td>949</td>
<td>872</td>
<td>583</td>
<td>3,083</td>
<td>5,684</td>
</tr>
<tr>
<td><strong>Sales and marketing</strong></td>
<td>$6,813</td>
<td>5,093</td>
<td>5,920</td>
<td>1,311</td>
<td>1,533</td>
<td>1,756</td>
<td>1,700</td>
<td>6,300</td>
<td>1,894</td>
<td>1,948</td>
<td>1,892</td>
<td>1,833</td>
<td>7,567</td>
<td>9,096</td>
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<tr>
<td><strong>General and administrative</strong></td>
<td>$10,196</td>
<td>7,332</td>
<td>5,915</td>
<td>1,810</td>
<td>1,386</td>
<td>3,327</td>
<td>1,800</td>
<td>8,323</td>
<td>2,290</td>
<td>2,107</td>
<td>2,107</td>
<td>2,340</td>
<td>8,844</td>
<td>9,800</td>
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<tr>
<td><strong>Restructuring Charge</strong></td>
<td>$358</td>
<td>(924)</td>
<td></td>
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<td></td>
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<td></td>
</tr>
<tr>
<td><strong>Provision for litigation settlement</strong></td>
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<tr>
<td><strong>Total Expenses</strong></td>
<td>$22,772</td>
<td>17,397</td>
<td>16,408</td>
<td>4,523</td>
<td>4,732</td>
<td>7,022</td>
<td>5,450</td>
<td>21,727</td>
<td>6,670</td>
<td>6,613</td>
<td>6,486</td>
<td>6,589</td>
<td>26,358</td>
<td>30,901</td>
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<tr>
<td><strong>Operating Income/EBIT</strong></td>
<td>(14,643)</td>
<td>161</td>
<td>1,163</td>
<td>(564)</td>
<td>(88)</td>
<td>(1,786)</td>
<td>2,008</td>
<td>(430)</td>
<td>679</td>
<td>949</td>
<td>872</td>
<td>583</td>
<td>3,083</td>
<td>5,684</td>
</tr>
<tr>
<td><strong>Operating Margin</strong></td>
<td>-34.7%</td>
<td>0.4%</td>
<td>2.9%</td>
<td>-6.3%</td>
<td>-0.8%</td>
<td>-13.6%</td>
<td>11.7%</td>
<td>-0.9%</td>
<td>3.9%</td>
<td>5.3%</td>
<td>5.0%</td>
<td>3.4%</td>
<td>4.4%</td>
<td>6.6%</td>
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<tr>
<td><strong>Interest Income &amp; Other Income (Exp.)</strong></td>
<td>1,067</td>
<td>383</td>
<td>247</td>
<td>0</td>
<td>(44)</td>
<td>(1)</td>
<td>0</td>
<td>(45)</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>200</td>
<td>50</td>
</tr>
<tr>
<td><strong>Income before Taxes</strong></td>
<td>(13,576)</td>
<td>544</td>
<td>1,410</td>
<td>(564)</td>
<td>(132)</td>
<td>(1,787)</td>
<td>2,008</td>
<td>(475)</td>
<td>729</td>
<td>999</td>
<td>922</td>
<td>633</td>
<td>3,283</td>
<td>5,734</td>
</tr>
<tr>
<td><strong>Provision for Income Taxes</strong></td>
<td>12,376</td>
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<td>0</td>
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<td>0</td>
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<td>0</td>
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<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Net Income</strong></td>
<td>(25,952)</td>
<td>544</td>
<td>1,410</td>
<td>(564)</td>
<td>(132)</td>
<td>(1,787)</td>
<td>2,008</td>
<td>(475)</td>
<td>729</td>
<td>999</td>
<td>922</td>
<td>633</td>
<td>3,283</td>
<td>5,734</td>
</tr>
<tr>
<td><strong>Net Margin</strong></td>
<td>-61.5%</td>
<td>1.2%</td>
<td>3.5%</td>
<td>-6.3%</td>
<td>-1.2%</td>
<td>-13.7%</td>
<td>11.7%</td>
<td>-1.0%</td>
<td>4.2%</td>
<td>5.6%</td>
<td>5.3%</td>
<td>3.7%</td>
<td>4.7%</td>
<td>6.7%</td>
</tr>
<tr>
<td><strong>EPS - From Operations</strong></td>
<td>($1.86)</td>
<td>$0.03</td>
<td>$0.11</td>
<td>($1.7)</td>
<td>$0.02</td>
<td>$0.14</td>
<td>$0.13</td>
<td>$0.06</td>
<td>$0.06</td>
<td>$0.06</td>
<td>$0.03</td>
<td>$0.18</td>
<td>$0.31</td>
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<tr>
<td><strong>EPS - As Reported</strong></td>
<td>($1.86)</td>
<td>$0.02</td>
<td>$0.08</td>
<td>($1.0)</td>
<td>$0.01</td>
<td>$0.11</td>
<td>$0.03</td>
<td>$0.04</td>
<td>$0.05</td>
<td>$0.03</td>
<td>$0.03</td>
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<td>17,577</td>
<td>17,577</td>
<td>17,577</td>
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<td>17,583</td>
<td>17,750</td>
<td>18,000</td>
<td>18,250</td>
<td>18,250</td>
<td>18,063</td>
<td>18,500</td>
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<tr>
<td><strong>EBITDA</strong></td>
<td>($11,433)</td>
<td>$2,621</td>
<td>2,235</td>
<td>($313)</td>
<td>$202</td>
<td>($1,500)</td>
<td>$2,298</td>
<td>$687</td>
<td>$969</td>
<td>$1,239</td>
<td>$1,162</td>
<td>$873</td>
<td>$4,243</td>
<td>$6,834</td>
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<td><strong>Growth Rates: Yr/Yr</strong></td>
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<td></td>
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<td></td>
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<tr>
<td>Revenue</td>
<td>NM</td>
<td>5%</td>
<td>-8%</td>
<td>-9%</td>
<td>13%</td>
<td>29%</td>
<td>52%</td>
<td>22%</td>
<td>44%</td>
<td>67%</td>
<td>33%</td>
<td>-1%</td>
<td>40%</td>
<td>23%</td>
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<td>Gross Profit</td>
<td>NM</td>
<td>116%</td>
<td>0%</td>
<td>-10%</td>
<td>12%</td>
<td>21%</td>
<td>60%</td>
<td>21%</td>
<td>86%</td>
<td>63%</td>
<td>41%</td>
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<td>38%</td>
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<td>Operating Income</td>
<td>NM</td>
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<td>-133%</td>
<td>-509%</td>
<td>232%</td>
<td>-137%</td>
<td>-220%</td>
<td>-1178%</td>
<td>-149%</td>
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<tr>
<td>Net Income</td>
<td>NM</td>
<td>-102%</td>
<td>159%</td>
<td>-676%</td>
<td>-168%</td>
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<td>221%</td>
<td>-134%</td>
<td>-229%</td>
<td>-857%</td>
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<td>-791%</td>
<td>75%</td>
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<tr>
<td>EPS - From Operations</td>
<td>NM</td>
<td>-102%</td>
<td>221%</td>
<td>-122%</td>
<td>-351%</td>
<td>-64%</td>
<td>172%</td>
<td>20%</td>
<td>-1060%</td>
<td>-509%</td>
<td>956%</td>
<td>-60%</td>
<td>99%</td>
<td>58%</td>
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</tbody>
</table>

**Margin Analysis**

| Gross Margin | 19.3% | 39.8% | 43.1% | 44.0% | 43.3% | 40.0% | 43.6% | 42.7% | 42.1% | 42.1% | 42.2% | 42.3% | 42.1% | 42.7% |
| Operating Margin | -34.7% | 0.4% | 2.9% | -6.3% | -0.8% | -13.6% | 11.7% | -0.9% | 3.9% | 5.3% | 5.0% | 3.4% | 4.4% | 6.6% |
| EBITDA | -27.1% | 5.9% | 5.5% | -3.5% | 1.9% | -11.5% | 13.4% | 1.4% | 5.6% | 6.9% | 6.7% | 5.1% | 6.1% | 8.0% |
| Net Margin | -61.5% | 1.2% | 3.5% | -6.3% | -1.2% | -13.7% | 11.7% | -1.0% | 4.2% | 5.6% | 5.3% | 3.7% | 4.7% | 6.7% |
**Disclosures:**

**Feltl and Company Rating System:** Feltl and Company utilizes a four tier rating system for potential total returns over the next 12 months, and a three-tier system for risk assessment.

**Potential Total Return Assessment**

**Strong Buy:** The stock is expected to have total return potential of at least 30%. Catalysts exist to generate higher valuations, and positions should be initiated at current levels.

**Buy:** The stock is expected to have total return potential of at least 15%. Near term catalysts may not exist and the common stock needs further time to develop. Investors requiring time to build positions may consider current levels attractive.

**Hold:** The stock is expected to have total return potential of less than 15%. Fundamental events are not present to make it either a Buy or a Sell. The stock is an acceptable longer-term holding.

**Sell:** Expect a negative total return. Current positions may be used as a source of funds.

**Related Risk Assessment**

**Speculative:** Business and financial risks are significantly greater than the market risk. The company has an inconsistent operating history and the share price may have significant volatility.

**Aggressive:** Business and financial risks are higher than the market risk. The company has a history of revenue growth and/or operating profits. The share price may be more volatile than the general market.

**Market:** Business and financial risks are in line with the general market.

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As of the end of the month preceding the date of publication of this report, Feltl and Company did not beneficially own 1% or more of any class of common equity securities of the subject company.

Feltl and Company has not been engaged for investment banking services with the subject company during the past twelve months and does not anticipate receiving compensation for such services in the next three months.

The analyst or any member of his/her household does not hold a long or short position, options, warrants, rights or futures of this security in their personal account(s).
The analyst has not received any compensation for any investment banking business with this company in the past twelve months and does not expect to receive any in the next three months.

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Feltl and Company has not served as a broker, either as agent or principal, buying back stock for the subject company’s account as part the company’s authorized stock buy-back program in the last twelve months. Feltl & Co. may possibly serve as the company’s broker, either as agent or principal, as part of the company’s authorized buy-back program in the next three months.

There is not any actual material conflict of interest that either the analyst or Feltl and Company is aware of.

Feltl and Company provided investment banking services for 3% of the research covered companies over the last twelve months, of which one was rated Buy/Strong Buy and none were rated Hold or Sell.

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<th>Date</th>
<th>Nature of Report</th>
<th>Rating</th>
<th>Price Target</th>
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<td>12/5/03</td>
<td>Coverage Initiated</td>
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Chart: Reuters
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04/03/03