SI INTERNATIONAL INC
Form 10-Q
November 07, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x	**QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTER ENDED September 29, 2007**
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number

000-50080

SI International, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**52-2127278**

(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
12012 Sunset Hills Road **Reston, Virginia** (Address of principal executive offices)	**20190-5869** (Zip Code)

Registrant s telephone number, including area code: **(703) 234-7000**

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

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

Large accelerated filer o Accelerated filer x Non-accelerated filer o

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

As of November 1, 2007, there were 13,177,598 shares outstanding of the registrant s common stock.

SI INTERNATIONAL, INC.

FORM 10-Q

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PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

SI International, Inc. and Subsidiaries

Consolidated Balance Sheets

(Amounts in thousands, except share data)

Unaudited

	September 29, 2007	December 30, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 6,798	$ 19,457
Accounts receivable, net	110,618	91,972
Other current assets	9,041	8,627
Total current assets	126,457	120,056
Property and equipment, net	14,770	12,372
Goodwill	264,822	220,626
Intangible assets, net	29,052	20,418
Other assets	12,083	7,661
Total assets	$ 447,184	$ 381,133
Liabilities and stockholders equity		
Current liabilities:		
Note Payable line of credit	$ 20,000	$
Current portion of long-term debt	1,004	754
Accounts payable	24,263	20,715
Note payable former owner of acquired business		5,839
Accrued expenses and other current liabilities	33,756	28,547
Total current liabilities	79,023	55,855
Long-term debt, net of current portion	93,512	69,452
Deferred income tax, net	9,365	8,961
Other long-term liabilities	10,082	7,653
Stockholders equity:		
Common stock $0.01 par value per share; 50,000,000 shares authorized; 13,060,159 and 12,967,377 shares issued and outstanding as of September 29, 2007 and December 30, 2006, respectively	131	130
Additional paid-in capital	187,305	184,845
Retained earnings	68,205	54,065
Accumulated other comprehensive (loss) income	(439)	172
Total stockholders equity	255,202	239,212

Total liabilities and stockholders equity	$	447,184	$	381,133

<u>See accompanying notes</u>

SI International, Inc. and Subsidiaries

Consolidated Statements of Operations

(Amounts in thousands, except per share data)

Unaudited

	Three Months Ended		Three Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Revenue	$ 141,109	$ 119,869	$ 373,602	$ 346,334
Operating costs and expenses:				
Cost of services	92,915	77,092	237,541	218,669
Selling, general and administrative	36,462	30,652	102,681	93,830
Depreciation and amortization	935	756	2,548	1,977
Amortization of intangible assets.	1,370	823	2,887	2,293
Total operating costs and expenses	131,682	109,323	345,657	316,769
Income from operations	9,427	10,546	27,945	29,565
Other (expense) income	(16)	31	486	(40)
Interest expense	(2,201)	(1,720)	(5,170)	(6,195)
Income before provision for income taxes	7,210	8,857	23,261	23,330
Provision for income taxes	2,827	3,498	9,121	9,215
Net income	$ 4,383	$ 5,359	$ 14,140	$ 14,115
Earnings per common share:				
Basic	$ 0.34	$ 0.42	$ 1.09	$ 1.14
Diluted	$ 0.33	$ 0.41	$ 1.06	$ 1.11
Basic weighted-average shares outstanding	13,050	12,891	13,012	12,361
Diluted weighted-average shares outstanding	13,339	13,198	13,294	12,753

See accompanying notes

SI International, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(Amounts in thousands)

Unaudited

	Nine Months Ended September 29, 2007		Nine Months Ended September 30, 2006	
Cash flows from operating activities:				
Net income	$	14,140	$	14,115
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization		2,548		1,977
Amortization of intangible assets		2,887		2,293
Loss on disposal of fixed assets		39		10
Stock-based compensation		843		140
Amortization of deferred financing costs and debt discount		626		1,750
Changes in operating assets and liabilities, net of effect of acquisitions:				
Accounts receivable, net		(6,376)		11,307
Other current assets		(254)		(10)
Other assets		(4,770)		(1,544)
Accounts payable and Accrued expenses and other current liabilities		(61)		(13,626)
Other long-term liabilities		3,031		3,783
Net cash provided by operating activities		12,653		20,195
Cash flows from investing activities:				
Purchase of property and equipment		(4,678)		(7,006)
Proceeds from sale of marketable securities		43,250		27,850
Purchase of marketable securities		(43,250)		(20,000)
Former owner payable		(6,000)		(10,322)
Cash paid for business acquisitions, net of cash assumed		(60,371)		(48,107)
Net cash used in investing activities		(71,049)		(57,585)
Cash flows from financing activities:				
Proceeds from exercise of stock options		1,373		6,431
Proceeds from issuance of common stock				40,255
Income tax benefit from stock option exercises		244		1,671
Proceeds from line of credit, net		20,000		
Proceeds from long-term debt		25,000		30,000
Repayments of long-term debt		(690)		(50,856)
Payments of debt issuance costs		(108)		(552)
Repayments of capital lease obligations		(82)		(87)
Net cash provided by financing activities		45,737		26,862
Net change in cash and cash equivalents		(12,659)		(10,528)
Cash and cash equivalents, beginning of period		19,457		26,160
Cash and cash equivalents, end of period	$	6,798	$	15,632
Supplemental disclosures of cash flow information:				
Cash payments for interest	$	5,687	$	5,334
Cash payments for income taxes	$	7,924	$	6,607
Purchases of assets under capital leases	$		$	198

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See accompanying notes

SI International, Inc. and Subsidiaries

Notes to consolidated financial statements

(Unaudited)

1. Basis of Presentation:

The accompanying unaudited consolidated financial statements of SI International, Inc. and its subsidiaries have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the quarter ended September 29, 2007 are not necessarily indicative of the results that may be expected for the year ending December 29, 2007. For further information, refer to the financial statements and footnotes included in SI International s Annual Report on Form 10-K for the year ended December 30, 2006. References to the Company, we, us and our refer to SI International, Inc. and its subsidiaries.

2. Summary of significant accounting policies:

Principles of consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany transactions and accounts have been eliminated in consolidation.

Use of estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Reporting periods

The Company s fiscal year is based on the calendar year and ends each year on the Saturday nearest, but not falling after, December 31 of that year. As a result, our fiscal year may be comprised of 52 or 53 weeks. Typically, fiscal quarters also end on the Saturday nearest, but not falling after, the end of the calendar quarter. However, we will end those fiscal quarters presented in our Forms 10-Q (the first three fiscal quarters) on the Saturday which provides us with a 13 week quarter even if that Saturday falls after the end of the calendar quarter. As a result, in the future, if our fiscal year comprises 53 weeks, the first three quarters shall each be comprised of 13 weeks and the fourth quarter shall be comprised of

14 weeks. Consistent with this policy, our third quarter ended September 29, 2007 was a 13-week quarter.

Cash and cash equivalents

We consider cash on deposit and all highly liquid investments with original maturities of three months or less to be cash and cash equivalents.

Revenue Recognition

The Company recognizes revenue when a contract has been executed, the contract price is fixed and determinable, delivery of services or products has occurred, and collectibility of the contract price is considered probable and can be reasonably estimated. Revenue is earned under cost reimbursable, time and materials and fixed price contracts.

Under cost reimbursable contracts, the Company is reimbursed for allowable costs and paid a fee, which may be fixed or performance-based. Revenue on cost reimbursable contracts is recognized as costs are incurred plus an estimate of applicable fees earned. The Company considers fixed fees under cost reimbursable contracts to be earned in proportion of the allowable costs incurred in performance of the contract. For cost reimbursable contracts that include performance based fee incentives, the Company recognizes the relevant portion of the expected fee to be awarded by the customer at the time such fee can be reasonably estimated, based on factors such as the Company s prior award experience and communications with the customer regarding performance.

Revenue on time and materials contracts is recognized based on direct labor hours expended at contract billing rates and adding other billable direct costs. For fixed price contracts that are based on unit pricing or level of effort, the Company recognizes revenue for the number of units delivered in any given fiscal period. For fixed price contracts in which the Company is paid a specific amount to provide a particular service for a stated period of time, revenue is recognized ratably over the service period.

For fixed price contracts that provide for the delivery of a specific product with related customer acceptance provisions, revenue is recognized upon product delivery and customer acceptance. However, a significant portion of the Company s fixed price-completion contracts involve the design and development of complex client systems. For those contracts that are within scope of SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*, revenue is recognized on the percentage-of-completion method using costs incurred in relation to total estimated costs.

The Company s contracts with agencies of the government are subject to periodic funding by the respective contracting agency. Funding for a contract may be provided in full at inception of the contract or ratably throughout the contract as the services are provided. In evaluating the probability of funding for purposes of assessing collectibility of the contract price, the Company considers its previous experiences with its customers, communications with its customers regarding funding status, and the Company s knowledge of available funding for the contract or program. If funding is not assessed as probable, revenue recognition is deferred until realization is deemed probable.

Contract revenue recognition inherently involves estimation, including the contemplated level of effort to accomplish the tasks under contract, the cost of the effort, and an ongoing assessment of progress toward completing the contract. From time to time, as part of normal management processes, facts develop that require management to revise its estimated total costs or revenue expected. The cumulative impact of any revisions to estimates and the full impact of anticipated losses on any type of contract are recognized in the period in which they become known.

The allowability of certain costs under government contracts is subject to audit by the government. Certain indirect costs are charged to contracts using provisional or estimated indirect rates, which are subject to later revision based on government audits of those costs. Management is of the opinion that costs subsequently disallowed, if any, would not be significant.

Significant customers

Revenue generated from contracts with the Federal Government or prime contractors doing business with the Federal Government accounted for a significant percentage of revenue in the fiscal quarters ending September 29, 2007 and September 30, 2006.

	Three Months Ended				Nine Months Ended			
	September 29, 2007		**September 30, 2006**		**September 29, 2007**		**September 30, 2006**	
Department of Defense	47.4	%	46.6	%	45.9	%	47.2	%
Federal civilian agencies	51.7	%	52.3	%	53.0	%	51.3	%
Commercial entities	0.9	%	1.1	%	1.1	%	1.5	%

Total revenue		100.0%	100.0%	100.0%	100.0%

For the quarters ended September 29, 2007 and September 30, 2006 our Command, Control, Communications, Computer, Intelligence, Information, Technology, Surveillance, and Reconnaissance contract vehicle (C4I2TSR) was our only contract vehicle that generated more than 10% of our revenue. C4I2TSR is an indefinite delivery, indefinite quantity (ID/IQ) contract vehicle administered and primarily used by the U.S. Air Force Space Command, however, it is also available for use by different Federal Government agencies. As projects are issued under C4I2TSR for different customers, we assign and report revenue generated from any task order to the appropriate business unit. Under this approach, for the three and nine months ended September 29, 2007, revenue from the C4I2TSR contract represented approximately 14.4% and 16.8% of our revenue, respectively. For the three and nine months ended September 30, 2006, our C4I2TSR contract represented approximately 22.1% and 21.4% of our revenue, respectively.

Deferred financing costs

Costs incurred in establishing our credit facility are deferred and amortized as interest expense over the term of the related debt using the effective interest method. These deferred costs are reflected as a component of other assets in the accompanying consolidated balance sheets. The deferred financing costs consist of the following (in thousands):

	September 29, 2007		December 30, 2006	
Deferred loan costs	$	5,635	$	5,527
Accumulated amortization		(3,828)		(3,363)
	$	1,807	$	2,164

Fair value of financial instruments

The Company s financial instruments consist primarily of cash and cash equivalents, accounts receivable, accounts payable, credit facilities, and notes payable. In management s opinion, the carrying amounts of these financial instruments approximate their fair values at September 29, 2007 and December 30, 2006.

Stock-based compensation

Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123R using the modified prospective transition method which required the Company to record compensation cost related to unvested stock awards as of December 31, 2005 by recognizing the unamortized grant date fair value of these awards over the remaining service periods of those awards with no charge in historical reported earnings. Awards granted after December 31, 2005 are valued at fair value in accordance with the provisions of SFAS No. 123R and recognized as an expense on a straight-line basis over the service periods of each award. The Company accelerated the vesting of unvested stock options previously awarded to employees, officers and directors in December 2005. The Company had no unvested stock options on January 1, 2006. The total stock compensation expense recognized for stock options and restricted stock awards during the three month and nine month periods ended September 29, 2007 was approximately $0.3 million and $0.8 million, respectively. The total remaining unrecognized compensation expense related to the unvested options and restricted stock awards as of September 29, 2007 was $2.6 million and $1.7 million, respectively.

The fair value of each option is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions used for grants during the fiscal periods ended September 29, 2007 and September 30, 2006:

	Period Ended	
	September 29, 2007	September 30, 2006
Risk-free interest rate	4.67% 5.03%	4.67 4.82%
Expected life of options	5 years	5 years
Expected stock price volatility	34.5%	41.7%

Expected dividend yield	0%	0%

The risk-free interest is based on U.S. Treasury yields in effect at the time of grant over the expected term of the option. The expected life of options is derived from the Company s historical option exercise data. The expected stock price volatility is based on the historical volatility of the Company s common stock.

Prior to the adoption of SFAS No. 123R, the Company presented all tax benefits related to the exercise of stock options as operating cash flows in the consolidated statement of cash flows. SFAS No. 123R requires the cash flows resulting from the tax benefits generated from tax deductions in excess of the compensation costs recognized for those options to be classified as financing cash flows.

Earnings per share

Basic earnings per share is computed by dividing reported earnings available to common stockholders by the weighted average number of shares outstanding without consideration of common stock equivalents or other potentially dilutive securities. Diluted earnings per share give effect to common stock equivalents and other potentially dilutive securities outstanding during the period.

The following details the computation of net income per common share (in thousands):

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Net Income Basic and Diluted	$ 4,383	$ 5,359	$ 14,140	$ 14,115
Weighted average share calculation:				
Basic weighted-average shares outstanding	13,050	12,891	13,012	12,361
Treasury stock effect of stock options	289	307	282	392
Diluted weighted-average shares outstanding	13,339	13,198	13,294	12,753

Reclassifications

Certain prior year balances have been reclassified to conform to the presentation of the current year.

New accounting pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109, Accounting for Income Taxes . FIN 48 provides guidance on recognition, derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 requires an entity to recognize the financial statement impact of a tax position when it is more likely than not that the position will be sustained upon examination. The amount recognized is measured as the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. In addition, FIN 48 permits an entity to recognize interest and penalties related to tax uncertainties either as income tax expense or operating expenses.

The Company adopted the provisions of FIN 48 on January 1, 2007. The Company believes that its income tax filing positions will be sustained on audit and does not anticipate any adjustments that will result in a material effect on its financial position, results of operations or cash flows. Therefore, no reserves for uncertain income tax position have been recorded. The Company had recognized interest and penalties related to tax uncertainties as income tax expense and will continue this treatment upon adoption of FIN 48.

The Company is subject to U.S. federal income tax as well as to income tax of multiple state jurisdictions. Federal income tax returns of the Company are subject to IRS examination for the 2003 through 2006 tax years. State income tax returns are subject to examination for a period of three to six years after filing.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements . SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after December 15, 2007. The adoption of SFAS No. 157 is effective January 1, 2008 for the Company. The Company believes that the adoption of this statement will not have a material effect on its financial condition, results of operations or cash flows.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Liabilities Including an amendment of FASB Statement No. 115*, which permits entities to measure eligible items at fair value. For items where the fair value election is made, the Company will be required to report unrealized gains or losses in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating what effect, if any, the adoption of SFAS No. 159 will have on our financial position, results of operations, or cash flows.

3. Acquisitions:

On June 8, 2007, the Company acquired LOGTEC, Inc., an Ohio corporation (LOGTEC), pursuant to a Share Purchase Agreement dated May 23, 2007 (the LOGTEC Agreement). LOGTEC specializes in acquisition and program management, systems and network engineering and integration, software and web-based application development, data management and warehousing, information assurance, and training. LOGTEC s largest clients include the Air Force Materiel Command (AFMC) and Naval Air Systems Command (NAVAIR).

Under the terms of the LOGTEC Agreement, the Company acquired all of the outstanding capital stock of LOGTEC for $60.4 million in cash, including $1.0 million paid related to a preliminary working capital adjustment and $0.5 million of transaction costs, of which $5.9 million was deposited in escrow for 15 months after closing in order to secure post-closing indemnity obligations of the sellers. The purchase price is further subject to a two-way adjustment based upon whether the working capital of LOGTEC at the closing of the acquisition is above or below the target working capital specified in the LOGTEC Agreement. Additionally, the Company has made an election under Section 338(h)(10) of the Internal Revenue Code, which effects the after tax valuation of the LOGTEC acquisition. The transaction was funded through $10.4 million of cash-on-hand, borrowings of $25 million under the newly amended term loan under our credit facility, and borrowing of $25 million under our revolving line of credit under our credit facility. LOGTEC s trailing revenue for the year ending December 31, 2006 was approximately $54 million (unaudited).

Based on the preliminary valuation received from our independent appraiser, management has allocated approximately $44.2 million of the purchase price to goodwill based primarily on the excess of the purchase price over the estimated fair value of net assets acquired and approximately $11.5 million of the purchase price has been assigned to identifiable intangible assets of contractual customer relationships. These intangible assets are being amortized on an accelerated basis over their estimated useful life. The final results of the valuation may differ from management s estimate currently recorded, and the balances will be adjusted to reflect final results. However, management does not anticipate that any such adjustments will have a material effect on the Company s financial position or results of operations.

The total purchase price paid, including transaction costs of $0.5 million, has been preliminarily allocated as follows (in thousands):

Cash and cash equivalents	$84
Accounts receivable	12,269
Other current assets	222
Property and equipment	314
Accounts payable and accrued expenses	(8,197)
Intangible assets	11,520
Goodwill	44,243
Total consideration	$60,455

The following unaudited proforma combined condensed statements of operations (in thousands, except per share) set forth the consolidated results of operations of the Company for the three and nine months ended September 29, 2007 and September 30, 2006 as if the LOGTEC acquisition had occurred at the beginning of each period presented. This unaudited proforma information does not purport to be indicative of the actual financial position or the results that would actually have occurred if the combination had been in effect for the three and nine months ended September 29, 2007 and September 30, 2006.

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Revenue.	$ 141,109	$ 133,444	$ 401,038	$ 387,058
Net income	4,383	5,789	14,481	16,810
Diluted earnings per share	$ 0.33	$ 0.44	$ 1.09	$ 1.32

The operations of LOGTEC have been included in the Company s statement of operations since it was acquired.

4. Accounts receivable:

Accounts receivable consists of the following (in thousands):

	September 29, 2007	December 30, 2006
Billed accounts receivable	$ 50,589	$ 46,540
Unbilled accounts receivable:		
Currently billable	58,468	41,192
Unbilled retainages and milestone paymentsexpected to be billed within the next 12 months	2,875	5,609
Indirect costs incurred and charged to cost-plus contracts in excess of provisional billing rates	128	136
Total unbilled accounts receivable	61,471	46,937
Allowance for doubtful accounts	(1,442)	(1,505)
Accounts receivable, net	$ 110,618	$ 91,972

The currently billable amounts included as unbilled accounts receivable as of September 29, 2007 represent amounts that are billed during the following quarter of the current year. They are billings for services rendered prior to quarter-end, which are billed once necessary billing data has been collected and an invoice is produced.

5. Property and equipment:

Property and equipment consist of the following (in thousands):

	September 29, 2007	December 30, 2006
Computers and equipment	$ 12,213	$ 11,899
Software	4,231	2,972
Furniture and fixtures	6,251	5,072
Leasehold improvements	6,380	4,257
	29,075	24,200
Less: accumulated depreciation and amortization	(14,305)	(11,828)
Property and equipment, net	$ 14,770	$ 12,372

Property and equipment includes assets financed under capital lease obligations of approximately $0.3 million, net of accumulated amortization, as of September 29, 2007 and approximately $0.3 million, net of accumulated amortization, as of December 30, 2006.

6. Intangible assets:

Intangible assets consist of the following (in thousands):

	September 29, 2007	December 30, 2006
Contractual customer relationships	$37,856	$26,336
Non-compete agreements	150	150
Total intangible assets	38,006	26,486
Less: accumulated amortization	(8,954)	(6,068)
Intangible assets, net	$29,052	$20,418

7. Accrued expenses and other current liabilities:

Accrued expenses and other current liabilities consist of the following (in thousands):

	September 29, 2007	December 30, 2006
Accrued vacation	$9,434	$7,068
Accrued compensation	9,423	10,349
Accrued bonus	321	4,413
Deferred revenue	1,558	1,081
Other accrued liabilities	13,020	5,636
Accrued expenses and other current liabilities	$33,756	$28,547

8. Debt:

Debt consists of the following:

		September 29, 2007		December 30, 2006
		(in thousands)		(in thousands)
Credit facilities:				
Line of credit bears interest at LIBOR plus 200 to 275 base points or a specified base rate plus 100 to 175 basis points, interest due monthly, principal due February 9, 2010		$20,000		$
Term loan, as of September 29, 2007 bears interest at LIBOR plus 200 basis points or a specified base rate plus 100 basis points, with thirteen consecutive quarterly principal and interest payments of $250,904 starting on June 30, 2007, with the unpaid principal and interest of approximately $91.3 million due on February 9, 2011		94,516		70,206
Total debt		$114,516		$70,206

Since 2002, the Company has maintained a credit facility with Wachovia Bank, National Association (Wachovia Bank) acting as Administration Agent for a consortium of lenders. The credit facility has been amended from time to time when the Company has made acquisitions. The credit facility is secured by a pledge of substantially all of our current and future tangible and intangible assets, as well as those of our current and future subsidiaries, including accounts receivable, inventory and capital stock. On February 9, 2005, we entered into our Amended and Restated Credit Agreement, which was subsequently amended by a First Amendment dated February 27, 2006 (the Credit Agreement). The Credit Agreement consisted of a $60 million revolving credit facility expiring on February 9, 2010 and a term loan facility with an original principal balance of approximately $129.0 million expiring on February 9, 2011. As a result of the prepayment of principal, the Company had reduced the outstanding principal balance of the term loan to approximately $70.0 million prior to the LOGTEC acquisition.

On June 8, 2007, contemporaneously with the closing of the LOGTEC acquisition, we entered into a Second Amendment to the Amended and Restated Credit Agreement (Second Amendment). The Second Amendment increased the amount of outstanding term debt by $25 million, to a total of approximately $95 million. Additionally, the Company borrowed approximately $25 million under the revolving credit facility. The outstanding balance under the revolving credit facility will accrue interest at a variable rate, with interest only payments being required until the facility matures on February 9, 2010. The Company may repay either or both of the term loan facility and the revolving credit facility in whole or in part at anytime prior to their respective maturity dates. As we have the intent to repay the balance on the revolving credit facility within the next twelve months, we have classified the outstanding balance as a current liability.

9. Commitments and contingencies:

Leases

As of September 29, 2007, the Company has non-cancelable operating leases, primarily for real estate, that expire over the next ten years. Rental expense during the quarter ended September 29, 2007 was approximately $2.5 million, consistent with rental expense of approximately $2.5 million during the quarter ended September 30, 2006.

Contract cost audits

Payments to the Company on government cost reimbursable contracts are based on provisional, or estimated indirect rates, which are subject to audit on an annual basis by the Defense Contract Audit Agency (DCAA). The cost audits result in the negotiation and determination of the final indirect cost rates that the Company may use for the period(s) audited. The final rates, if different from the provisional rates, may create an additional receivable or liability for the Company. The Company s revenue recognition policy calls for revenue recognized on all cost reimbursable government contracts to be recorded at actual rates unless collectibility is not reasonably assured. To the extent the indirect rate differential creates a liability for the Company, the differential is recognized as a reduction to revenue when identified.

Litigation and claims

The Company is a party to litigation and legal proceedings that management believes to be a part of the ordinary course of our business. While we cannot predict the ultimate outcome of these matters, we currently believe that any ultimate liability arising out of these proceedings will not have a material adverse effect on our financial position. We may become involved in other legal and governmental, administrative or contractual proceedings in the future.

The SEI acquisition agreement provides for a purchase price adjustment based upon the working capital of SEI as of the closing date. Subsequent to the closing date, we received a payment of $1.6 million in connection with services performed prior to the closing date that SEI had not previously billed, and was not authorized to bill, its customer as of the closing date. The SEI selling stockholders have asserted that they are entitled to a credit in connection with the calculation of working capital adjustment in an amount equal to the amount received by us for this post-closing payment. We believe that, in accordance with GAAP, the SEI selling stockholders should not receive the benefit of the post-closing payment. In accordance with the terms of the SEI acquisition agreement, the parties have jointly submitted the issue to an independent accounting firm for resolution. We anticipate that this matter will be resolved before the end of 2007.

10. Stockholders equity:

Stock incentive plans

In April 2005, the Board of Directors voted to adopt the 2002 Amended and Restated Omnibus Stock Incentive Plan (the Amended and Restated Plan), and the Amended and Restated Plan was approved by our stockholders at the annual meeting of stockholders held in June 2005. The Amended and Restated Plan amends and restates the Plan by (i) increasing the number of shares of common stock reserved and available under the Plan by 1,000,000 shares to a total share allocation of 2,920,000, (ii) permitting the grant of deferred shares, performance shares and performance units, (iii) prohibiting repricing of options without prior stockholder approval, (iv) limiting the number of shares of common stock and performance units subject to awards a participant may receive in any calendar year to 300,000 and 500,000, respectively, and adding other administrative provisions to comply with the performance-based compensation exception to the deduction limit of Section 162(m) of the Internal Revenue Code of 1986, as amended; (v) eliminating the provision that previously provided for an automatic increase in the number of shares reserved for issuance under the Amended and Restated Plan each fiscal year by a number equal to the lesser of 160,000 shares or an amount determined by the Board of Directors, (vi) providing that non-qualified stock option grants will be priced at one hundred percent (100%) of fair market value; (vii) providing for minimum vesting periods of stock bonus awards, restricted common stock awards, stock appreciation rights, deferred shares, and other stock awards subject to the possible acceleration of the vesting schedule at the discretion of the administrator; (viii) providing that future amendments to the Amended and Restated Plan that increase the number of shares allocated, modify participation requirements, or materially increase benefits accruing to the participants under the Plan will be subject to stockholder approval; and (ix) making other technical changes to the Plan.

A summary of option activity under the plan as of September 29, 2007, is presented below:

	Options	Weighted-average exercise price
Outstanding at December 30, 2006	1,468,305	$22.33
2007 grants	132,400	28.42
2007 exercises	(86,584)	15.87
2007 forfeitures	(15,743)	28.20
Outstanding at September 29, 2007	1,498,378	$23.18
Options exercisable at September 29, 2007	1,234,893	$21.98

Prior to fiscal 2006, awards under the Company s stock incentive plan consisted principally of stock options. During fiscal 2006, the Company revised its stock incentive arrangement to provide restricted stock awards to directors and executives. The stock awards granted during fiscal 2006 were generally vested ratably over a period of four or five years. During fiscal 2007, the Company revised its stock incentive arrangement to issue restricted stock awards that will be fully vested only if the Company meets certain revenue targets determined by the Board of Directors.

A summary of restricted awards activity under the plan as of September 30, 2006, is presented below:

	Shares	**Weighted-average fair value**
Non-vested restricted stock outstanding at December 30, 2006	32,200	$29.98
2007 grants	75,200	28.48
2007 vestings	(6,198)	28.65
2007 forfeitures	(625)	28.61
Non vested restricted stock outstanding at September 29, 2007	100,577	$28.63

Stock repurchase program

During the Company s Board of Directors meeting on December 6, 2005, the Board authorized the repurchase of up to 300,000 shares of its common stock up to an aggregate maximum dollar amount of $8 million. The Company had approximately 13.1 million shares outstanding as of September 29, 2007. Timing and volume of any purchases will be guided by management s assessment of market conditions, securities law limitations, the number of shares of common stock outstanding, and alternative, potentially higher value uses for cash resources. The repurchase plan may be suspended or discontinued at any time without prior notice.

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

The following discussion and analysis should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this Form 10-Q. This discussion and analysis contains forward-looking statements that involve known and unknown risks, uncertainties, and other factors that may cause our actual results, level of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. In some cases, you can identify these statements by forward-looking words such as anticipate, believe, could, estimate, expect, intend, may, plan, potential, should, will, and would or similar words. You should read statements that contain these words carefully because they discuss our future expectations, contain projections of our future results of operations or of our financial position, or state other forward-looking information. We believe that it is important to communicate our future expectations to our investors. However, there may be events in the future that we are not able to predict accurately or control. In particular, statements that we make in this section relating to the sufficiency of anticipated sources of capital to meet our cash requirements are forward- looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including as a result of some of the factors described below, elsewhere in this Form 10-Q and in the section entitled Risk Factors in our Form 10-K for the fiscal year ended December 30, 2006. You should not place undue reliance on these forward-looking statements, which apply only as of the date of the filing of this Form 10-Q.

The Company s fiscal year is based on the calendar year and ends each year on the Saturday nearest, but not falling after, December 31 of that year. Typically, fiscal quarters also end on the Saturday nearest, but not falling after, the end of the calendar quarter. Similarly, we will end future fiscal quarters on the Saturday which provides us with a 13 week quarter to compare with the previous year s quarterly results even if that Saturday falls after the end of the calendar quarter. As a result, our fiscal year may be comprised of 52 or 53 weeks.

References to the Company, we, us and our refer to SI International, Inc. and its subsidiaries.

Overview

We are, first and foremost, a provider of information technology and network solutions (IT) to the Federal Government. Our clients include the Department of Defense (DoD), U.S. Air Force, U.S. Army, U.S. Navy, Department of State, Department of Homeland Security, Department of Energy, Department of Agriculture, Federal Retirement Thrift Investment Board, National Guard Bureau, and th