SRA INTERNATIONAL INC
Form 10-Q
February 02, 2006
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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 QUARTERLY PERIOD ENDED DECEMBER 31, 2005

OR

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

Commission File Number: 001-31334

SRA International, Inc.

(Exact name of Registrant as Specified in its Charter)

Delaware	**54-1360804**
(State or Other Jurisdiction of	**(I.R.S. Employer**
Incorporation or Organization)	**Identification No.)**
4350 Fair Lakes Court, Fairfax, Virginia	**22033**
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant s telephone number, including area code: (703) 803-1500

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 ¨ 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 or large accelerated filer in Rule 12b-2 of the Exchange Act.

x Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer

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

As of January 31, 2006, there were 40,641,812 shares outstanding of the registrant s class A common stock and 14,509,828 shares outstanding of the registrant s class B common stock.

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SRA INTERNATIONAL, INC.

QUARTERLY REPORT ON FORM 10-Q FOR THE THREE MONTHS

AND SIX MONTHS ENDED DECEMBER 31, 2005

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Part I. FINANCIAL INFORMATION

Item 1. Financial Statements

SRA INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(in thousands)

Assets

	December 31, 2005	June 30, 2005
Current assets:		
Cash and cash equivalents	$ 99,590	$ 162,973
Short-term investments	12,737	20,156
Accounts receivable, net	295,053	206,995
Prepaid expenses and other	29,740	19,931
Deferred income taxes, current	9,007	6,506
Total current assets	446,127	416,561
Total property and equipment, net	33,797	34,754
Other assets:		
Goodwill	169,284	89,214
Identified intangibles, net	28,116	17,661
Investments		5,172
Deferred compensation trust	7,607	5,755
Total other assets	205,007	117,802
Total assets	$ 684,931	$ 569,117

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

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SRA INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(in thousands, except share and per share amounts)

Liabilities and Stockholders Equity

	December 31, 2005	June 30, 2005
Current liabilities:		
Accounts payable and accrued expenses	$ 115,961	$ 75,383
Accrued payroll and employee benefits	69,802	49,486
Billings in excess of revenue recognized	7,700	6,616
Total current liabilities	193,463	131,485
Long-term liabilities:		
Deferred income taxes, noncurrent	274	106
Other long-term liabilities	9,576	8,434
Total long-term liabilities	9,850	8,540
Total liabilities	203,313	140,025
Commitments and contingencies		
Stockholders equity:		
Preferred stock, par value $0.20 per share; 5,000,000 shares authorized; none issued		
Class A common stock, par value $0.004 per share; 180,000,000 shares authorized; 41,044,603 and 39,239,400 shares issued as of December 31, 2005 and June 30, 2005; 40,303,100 and 38,419,877 shares outstanding as of December 31, 2005 and June 30, 2005	164	157
Class B common stock, par value $0.004 per share; 55,000,000 shares authorized; 14,749,828 and 15,627,466 shares issued and outstanding as of December 31, 2005 and June 30, 2005	59	63
Additional paid-in capital	254,061	231,754
Treasury stock, at cost	(4,379)	(4,839)
Deferred stock-based compensation	(880)	(343)
Retained earnings	232,593	202,300
Total stockholders equity	481,618	429,092
Total liabilities and stockholders equity	$ 684,931	$ 569,117

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

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SRA INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(in thousands, except share and per share amounts)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2005	2004	2005	2004
Revenue	$ 305,313	$ 211,212	$ 586,008	$ 414,686
Operating costs and expenses:				
Cost of services	231,004	155,942	441,244	307,488
Selling, general and administrative	45,446	29,846	89,103	59,122
Depreciation and amortization	4,643	3,155	8,653	6,037
Total operating costs and expenses	281,093	188,943	539,000	372,647
Operating income	24,220	22,269	47,008	42,039
Interest income, net	1,037	754	1,770	1,277
Income before taxes	25,257	23,023	48,778	43,316
Provision for income taxes	9,354	8,300	18,485	16,153
Net income	$ 15,903	$ 14,723	$ 30,293	$ 27,163
Earnings per share:				
Basic	$ 0.29	$ 0.28	$ 0.56	$ 0.52
Diluted	$ 0.28	$ 0.26	$ 0.53	$ 0.48
Weighted-average shares:				
Basic	54,809,608	52,601,438	54,536,713	52,293,730
Diluted	57,525,356	56,476,908	57,466,695	56,008,844

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

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SRA INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(in thousands)

	Six Months Ended December 31,	
	2005	**2004**
Cash flows from operating activities:		
Net income	$ 30,293	$ 27,163
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,653	6,037
Stock-based compensation	6,488	159
Tax benefits of stock option exercises		8,816
Deferred income taxes	(2,333)	(1,567)
Changes in assets and liabilities, net of the effect of acquisitions:		
Accounts receivable	(68,194)	(29,043)
Prepaid expenses and other	(4,108)	(19,441)
Accounts payable and accrued expenses	33,026	27,607
Accrued payroll and employee benefits	12,873	16,410
Billings in excess of revenue recognized	1,084	2,809
Other	(575)	(568)
Net cash provided by operating activities	17,207	38,382
Cash flows from investing activities:		
Capital expenditures	(4,960)	(7,671)
Sales and maturities of investments	13,072	8,515
Purchases of investments		(18,516)
Acquisition of Galaxy Scientific Corporation, net of cash acquired	(95,645)	
Acquisition of Spectrum Solutions Group, net of cash acquired	(8,802)	
Net cash used in investing activities	(96,335)	(17,672)
Cash flows from financing activities:		
Issuance of common stock	6,401	5,061
Tax benefits of stock option exercises	7,078	
Reissuance of treasury stock	2,266	
Net cash provided by financing activities	15,745	5,061
Net (decrease) increase in cash and cash equivalents	(63,383)	25,771
Cash and cash equivalents, beginning of period	162,973	143,367
Cash and cash equivalents, end of period	$ 99,590	$ 169,138
Supplemental disclosures of cash flow information:		

Cash paid during the period:		
Income taxes	$ 17,596	$ 14,209
Cash received during the period:		
Interest	$ 1,927	$ 1,264
Income taxes	$ 53	$ 513

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

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SRA INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Three Months and Six Months Ended December 31, 2005 and 2004

1. Basis of Presentation:

The accompanying unaudited condensed consolidated financial statements include the accounts of SRA International, Inc. (a Delaware corporation), and its wholly-owned subsidiaries (SRA or the Company) and have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in the annual financial statements, prepared in accordance with generally accepted accounting principles, have been omitted pursuant to those rules and regulations, although the Company believes that the disclosures made are adequate to make the information presented not misleading.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all necessary adjustments and reclassifications (all of which are of a normal, recurring nature) that are necessary for fair presentation of the periods presented. The results for the three months and six months ended December 31, 2005 are not necessarily indicative of the results to be expected for the full fiscal year. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company s latest annual report to the Securities and Exchange Commission on Form 10-K for the year ended June 30, 2005.

2. Nature of Business:

SRA provides information technology services and solutions primarily to clients in national security, civil government, and health care and public health. Since SRA s founding in 1978, the Company has derived substantially all of its revenue from services provided to federal government clients. SRA expects that services provided to federal government clients will continue to account for substantially all of its revenue for the foreseeable future.

Revenue from contracts with federal government agencies was 99 percent of total revenue for all periods presented herein. The National Guard, as a client group, accounted for approximately 11 percent of revenue for both the three and six months ended December 31, 2005 and 2004. The United States Agency for International Development as a client, accounted for approximately 12 percent and 11 percent of revenue for the three and six months ended December 31, 2004, respectively. No other client or client group accounted for more than 10 percent of revenue in the periods presented herein.

3. Earnings Per Share and Stock Options:

Basic earnings per share (EPS) is computed by dividing reported net income by the weighted-average number of common shares outstanding. Diluted EPS considers the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. The difference between basic and diluted weighted-average common equivalent shares with respect to the Company s EPS calculation is due entirely to the assumed exercise of stock options. The dilutive effect of stock options for each period reported is summarized below:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2005	**2004**	**2005**	**2004**
Basic weighted-average common shares outstanding	54,809,608	52,601,438	54,536,713	52,293,730
Effect of potential exercise of stock options	2,715,748	3,875,470	2,929,982	3,715,114
Diluted weighted-average common shares outstanding	57,525,356	56,476,908	57,466,695	56,008,844

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SRA INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Three Months and Six Months Ended December 31, 2005 and 2004

Stock options that could potentially dilute basic EPS in the future that were not included in the computation of diluted EPS, because to do so would have been antidilutive, were 1,499,650 and 750,000 for the three months ended December 31, 2005 and 2004, respectively and 1,443,060 and 375,000 for the six months ended December 31, 2005 and 2004, respectively.

On May 2, 2005, the Company s board of directors declared a two-for-one stock split of the Company s outstanding common stock in the form of a 100 percent stock dividend. The stock dividend was distributed on May 27, 2005 to stockholders of record on May 13, 2005. All per share amounts, outstanding shares of common stock, and common stock equivalents reported in the accompanying unaudited condensed consolidated financial statements and notes thereto have been adjusted to retroactively reflect the stock split.

4. Accounting for Stock-Based Compensation:

Stock-Based Benefit Plans

The Company maintained a key employee incentive plan that was approved by the Company s stockholders in November 1994. All options granted by the Company from November 1994 until January 2002 were granted under this 1994 plan. Following completion of the Company s initial public offering of stock, no additional options may be granted under this plan. Under the terms of the plan, options to purchase class A common stock or class B common stock were granted by the board of directors to key employees. The option price per share was determined by the board of directors and generally was no less than the fair value of the stock on the date of grant of the option. Prior to becoming publicly traded, the Company retained an independent valuation firm to assist the board of directors in assessing the fair value of the stock. Each option is exercisable within periods and in increments determined by the board of directors.

In March 2002, the Company adopted the SRA International, Inc. 2002 Stock Incentive Plan. Upon adoption, up to 7,058,822 shares of class A common stock were reserved for issuance under the 2002 plan. Pursuant to the terms of the 2002 plan, the number of shares authorized for issuance automatically increases at the beginning of each fiscal year, beginning with the fiscal year ended June 30, 2004. An additional 4,677,569 shares of class A common stock were reserved for issuance pursuant to the automatic increase feature of the 2002 plan through July 1, 2005. The 2002 plan provides for the grant of incentive stock options, non-statutory stock options, restricted stock, and other stock-based awards. The 2002 plan is administered by the compensation committee of the board of directors, which shall determine the number of shares covered by options, and the exercise price, vesting period, and duration of option grants. The board of directors also has the authority under the 2002 plan to determine the number of shares of common stock subject to any restricted stock or other stock-based awards and the terms and conditions of such awards. The 2002 plan expires in March 2012.

Adoption of SFAS No. 123R

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment, which requires that compensation costs related to share-based payment transactions be recognized in financial statements. SFAS No. 123R eliminates the alternative to use the intrinsic method of accounting provided for in Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, which generally resulted in no compensation expense recorded in the financial statements related to the grant of stock options to employees if certain conditions were met.

Effective July 1, 2005, the Company adopted SFAS No. 123R using the modified prospective method. Under this method, compensation costs for all awards granted after the date of adoption and the unvested portion

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SRA INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Three Months and Six Months Ended December 31, 2005 and 2004

of previously granted awards outstanding at the date of adoption will be measured at estimated fair value and included in operating expenses over the vesting period during which an employee provides service in exchange for the award. Accordingly, prior period amounts presented herein have not been restated to reflect the adoption of SFAS No. 123R.

Prior to the adoption of SFAS No. 123R, the Company reported all tax benefits resulting from the exercise of stock options as operating cash flows in the consolidated statements of cash flows. In accordance with SFAS No. 123R, for the period beginning July 1, 2005, excess tax benefits from the exercise of stock options are presented as financing cash flows. The excess tax benefits totaled $7.1 million for the six months ended December 31, 2005. Such benefits were $8.8 million for the six months ended December 31, 2004 and are presented as a component of operating cash flows.

As a result of adopting SFAS No. 123R, the Company recorded $3.3 million and $6.3 million of stock-based compensation, or $2.1 million and $3.9 million after-tax, in its statement of operations for the three and six months ended December 31, 2005, respectively. This stock-based compensation expense reduced both basic and diluted earnings per share by $0.04 and $0.07, for the three and six months ended December 31, 2005, respectively.

Fair Value Determination

The fair value concepts were not changed significantly in SFAS No. 123R; however, in adopting this Standard, companies must choose among alternative valuation models and amortization assumptions. The Company has elected to continue to use both the Black-Scholes-Merton option pricing model and straight-line amortization of compensation expense over the requisite service period of the grant. The Company will reconsider use of the Black-Scholes-Merton model if additional information becomes available in the future that indicates another model would be more appropriate, or if grants issued in future periods have characteristics that cannot be reasonably estimated using this model.

The Company has 10-year and 15-year options. The following weighted-average assumptions were used for option grants during the six months ended December 31, 2005:

Expected Volatility. The expected volatility of the Company s shares was estimated based upon the historical volatility of the Company s share price. The expected volatility factor used in valuing options granted during the six months ended December 31, 2005 was 32 percent.

Expected Term. The expected term was estimated based upon exercise experience of option grants made in the past to Company employees. Historical experience shows that employees typically exercise options prior to the end of the contractual term. The expected term used in valuing options granted during the six months ended December 31, 2005 was five years.

Risk-free Interest Rate. The Company bases the risk-free interest rate used in the Black-Scholes-Merton valuation method on the implied yield available on a U.S. Treasury note with a term equal to the expected term of the underlying grants. The weighted-average risk-free interest rate used in valuing options granted during the six months ended December 31, 2005 was 4.2 percent.

Dividend Yield. The Black-Scholes-Merton valuation model calls for single expected dividend yield as an input. The Company has not paid dividends in the past nor does it expect to pay dividends in the future. As such, the Company used a dividend yield percentage of zero.

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SRA INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Three Months and Six Months Ended December 31, 2005 and 2004

Stock Compensation Expense

The Company recognized compensatory stock option expense on stock options issued below fair market value or upon modification of option terms of $35,000 and $88,000 for the three and six months ended December 31, 2005, respectively. This expense related to options granted in December 2001. Deferred stock-based compensation related to the stock options issued below fair market value was zero as of December 31, 2005.

The Company recorded $3.3 million and $6.3 million of stock-based compensation expense for the three and six months ended December 31, 2005, respectively, in addition to the stock compensation expense recorded above.

In prior years, while accounting for stock options under APB No. 25 and disclosing a pro forma expense calculation under SFAS No. 123, the Company did not include a forfeiture rate when calculating pro forma expense related to the options. In accordance with SFAS No. 123R, the Company estimated forfeitures and is recognizing compensation expense only for those share-based awards that are expected to vest.

As of December 31, 2005, there was $31.8 million of total unrecognized compensation cost related to nonvested share-based compensation arrangements. This cost is expected to be fully amortized in four years, with half of the total amortization cost being recognized within the next 16 months.

Stock Option Activity

During the six months ended December 31, 2005, the Company granted stock options to purchase 1,554,510 shares of class A common stock at a weighted-average exercise price of $34.75 per share, the fair value of class A common stock on the date of grant. The Black-Scholes-Merton weighted-average value of options granted during the six months ended December 31, 2005 was $12.28 per share. These options vest at the rate of 25 percent per year over four years, beginning on the date of grant. The options expire ten years from the grant date. During the six months ended December 31, 2005, the Company also granted 29,250 shares of restricted stock at an average price of $29.70 per share, that will vest at the rate of 25 percent per year over four years.

The following table summarizes stock option activity for the six months ended December 31, 2005:

	Number of Shares	Weighted-Average Exercise Price	Aggregate Intrinsic Value (in thousands)
Shares under option, July 1, 2005	8,028,226	$ 12.54	
Options granted	1,554,510	34.75	
Options exercised	(883,663)	6.60	
Options cancelled and expired	(166,091)	24.96	
Shares under option, December 31, 2005	8,532,982	$ 16.96	$ 115,861
Options exercisable at December 31, 2005	4,289,935	$ 9.31	$ 91,076
Shares reserved for equity awards at December 31, 2005	4,896,309		

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SRA INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Three Months and Six Months Ended December 31, 2005 and 2004

Information with respect to stock options outstanding and stock options exercisable at December 31, 2005 was as follows:

Range of Exercise Price		Options Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price
$ 0.20	$ 0.30	316,714	1.4 years	$ 0.29
$ 2.39	$ 5.07	2,107,250	7.8	4.05
$10.85	$16.80	2,485,952	10.0	14.12
$19.39	$35.40	3,623,066	9.1	27.88

Range of Exercise Price		Options Exercisable	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price
$ 0.20	$ 0.30	316,714	1.4 years	$ 0.29
$ 2.39	$ 5.07	2,106,221	7.8	4.05
$10.85	$16.80	1,322,596	10.2	13.94
$19.39	$31.61	544,404	8.6	23.68

Pro Forma Disclosures

Under the modified prospective method, results for the three and six months ended December 31, 2004 were not restated to include stock option expense. The previously disclosed pro forma effects of recognizing the estimated fair value of stock-based employee compensation for the three and six months ended December 31, 2004 (in thousands, except per share amounts) are presented below.

	Three Months Ended December 31, 2004	Six Months Ended December 31, 2004

Net income, as reported	$ 14,723	$ 27,163
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	77	159
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(1,425)	(2,628)
Pro forma net income	$ 13,375	$ 24,694
Earnings per share:		
Basic as reported	$ 0.28	$ 0.52
Basic pro forma	$ 0.25	$ 0.47
Diluted as reported	$ 0.26	$ 0.48
Diluted pro forma	$ 0.24	$ 0.44

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SRA INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Three Months and Six Months Ended December 31, 2005 and 2004

5. Accounts Receivable:

Accounts receivable, net as of December 31, 2005 and June 30, 2005, consisted of the following (in thousands):

	December 31, 2005	June 30, 2005
Billed and billable, net of allowance of $1,588 as of December 31, 2005 and $1,159 of June 30, 2005	$ 279,178	$ 195,140
Unbilled:		
Retainages	5,634	4,444
Revenue recorded in excess of milestone billings on fixed-price contracts	4,889	3,783
Revenue recorded in excess of contractual authorization, billable upon receipt of contractual amendments/documents	7,340	5,480
Allowance	(1,988)	(1,852)
Total unbilled	15,875	11,855
Total accounts receivable	$ 295,053	$ 206,995

The billable receivables included in the billed and billable line item above represent primarily revenue earned in the final month of the reporting period and were billable as of the balance sheet date. These billable receivables are typically billed and collected within 90 days of the balance sheet date.

Consistent with industry practice, certain receivables related to long-term contracts and programs are classified as current, although a portion of these amounts is not expected to be billed and collected within one year. Unbilled accounts receivable at December 31, 2005 are expected to be billed and collected within one year except for approximately $2.1 million related to a portion of retainages.

6. Commitments and Contingencies:

Government Contracting

Payments to the Company on cost-plus-fee contracts, and some elements of time-and-material contracts, are provisional and are subject to adjustment upon audit by the Defense Contract Audit Agency, or DCAA. Audits through June 30, 2003 have been completed. In the opinion of management, audit adjustments that may result from audits for periods after June 30, 2003 are not expected to have a material effect on the Company s financial position, results of operations, or cash flows.

Additionally, federal government contracts, by their terms, generally can be terminated at any time by the federal government, without cause, for the convenience of the federal government. If a federal government contract is so terminated, SRA would be entitled to receive compensation for the services provided and costs incurred through the time of termination, plus a negotiated amount of profit. Federal government contractors who fail to comply with applicable government procurement-related statutes and regulations may be subject to potential contract termination, suspension and debarment from contracting with the government, or other remedies. Management believes the Company has complied with all applicable procurement-related statutes and regulations.

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SRA INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Three Months and Six Months Ended December 31, 2005 and 2004

Litigation

The Company is involved in various legal proceedings concerning matters arising in the ordinary course of business. The Company currently believes that any ultimate liability arising out of these proceedings will not have a material adverse effect on the Company s financial position, results of operations, or cash flows.

7. Acquisition of Galaxy Scientific Corporation:

In July 2005, the Company completed its acquisition of Galaxy Scientific Corporation, or Galaxy, a privately-held provider of systems engineering, information technology, and tactical communication services and solutions to the federal government. Galaxy specializes in command and control, communications, computers and intelligence (C4I) tactical systems; information assurance; information technology; training systems; engineering support; and safety and security technologies. The Company acquired Galaxy for approximately $98.7 million, net of acquisition costs, from cash on hand. Pursuant to the requirements of SFAS No. 141, Business Combinations, the effect of the acquisition did not meet the criteria of a material and significant acquisition, and therefore, pro forma disclosures are not presented in these condensed consolidated financial statements.

8. Acquisition of Spectrum Solutions Group:

In November 2005, the Company acquired Spectrum Solutions Group, or Spectrum, a privately-held provider of enterprise solutions to the federal government. Spectrum focuses on achieving organizational improvement through the application of enterprise solutions, such as Oracle and Peoplesoft applications and technologies, to its customers throughout the federal government, including the Departments of Homeland Security and Health and Human Services. The Company acquired Spectrum for approximately $9.7 million, net of acquisition costs, from cash on hand. Pursuant to the requirements of SFAS No. 141, Business Combinations, the effect of the acquisition did not meet the criteria of a material and significant acquisition, and therefore, pro forma disclosures are not presented in these condensed consolidated financial statements.

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

FORWARD-LOOKING STATEMENTS

The matters discussed in this Management s Discussion and Analysis of Financial Condition and Results of Operations, and elsewhere in this Form 10-Q, constitute forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995. These statements involve known and unknown risks, uncertainties, and other factors that may cause our actual results, levels 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 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 or control accurately. The factors listed in the section captioned RISK FACTORS, as well as any cautionary language in this Form 10-Q, provide examples of risks, uncertainties, and events that may cause our actual results to differ materially from the expectations we describe in our forward-looking statements.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this Form 10-Q. Subsequent events and developments may cause our views to change. However, while we may elect to update these forward-looking statements at some point in the future, we specifically disclaim any obligation to do so.

OVERVIEW

We provide information technology services primarily to the federal government. Our service offerings include strategic consulting, systems design, development and integration, and outsourcing and operations management. In addition, we develop business solutions for text and data mining, contingency and disaster response planning, information assurance, environmental strategies, conflict management and dispute resolution, enterprise architecture, network operations and management, enterprise systems management and wireless integration services. We provide services in three target markets: national security, which includes the defense, intelligence and homeland security communities; civil government; and health care and public health.

Since our founding in 1978 we have derived substantially all of our revenue from services provided to federal government clients. We expect that federal government clients will continue to account for substantially all of our revenue for the foreseeable future. According to the *Federal IT Market Forecast, FY 2005-FY 2010* report, published by INPUT, an independent federal government research firm, the federal information technology market will grow at a compound annual growth rate of 5.9% from 2005 to 2010. In order to grow more rapidly than the market, we will need to take market share from our competitors. Our growth is driven in part by contract awards and how we build out our contracts. Ideally, the level of quarterly business awards would exceed the revenue booked in the quarter to drive backlog growth. However, we do not control when customers award contracts and we expect the absolute value of contracts we receive each quarter to remain volatile.

We work with the federal government under three primary contract types: cost-plus-fee, time-and-materials, and fixed-price contracts. Cost-plus-fee contracts are typically lower risk arrangements and thus yield lower profit margins than time-and-materials and fixed-price arrangements. Time-and-materials and fixed-price contracts typically generate higher profit margins reflecting their generally higher risk. Where customer requirements are clear, we prefer to enter into time-and-materials and fixed-price arrangements rather than cost-plus-fee arrangements.

Typically under fixed-price contracts, as compared with cost-plus-fee contracts, the customer can save money and we can earn better margins, given the more specific delivery requirements of these structures.

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Most of our revenue is generated based on services provided either by our employees or subcontractors. To a lesser degree, the revenue we earn includes reimbursable travel and other items to support the contractual effort, and third-party hardware and software that we purchase and integrate for customers as part of the solutions that we provide. Thus, once we win new business, the key to delivering the revenue is through hiring new employees to meet customer requirements, retaining our employees, and ensuring that we deploy them on direct-billable jobs. Therefore, we closely monitor hiring success, attrition trends, and direct labor utilization. A key challenge in growing our business is to hire enough employees with appropriate security clearances. Since we earn higher profits from the labor services that our employees provide compared with subcontracted efforts and other reimbursable items such as hardware and software purchases for customers, we seek to optimize our labor content on the contracts we win. The level of hardware and software purchases we make for customers may vary from period to period depending on specific contract and customer requirements.

Cost of services includes labor, or the salaries and wages of our employees, plus fringe benefits; the costs of subcontracted labor and outside consultants; third-party material, such as hardware and software that we purchase for customer solutions; and other direct costs, such as travel incurred to support contract efforts. Since we earn higher profits on our own labor services, we expect the ratio of cost of services to revenue to decline when our labor services mix increases relative to subcontracted labor or third-party material. Conversely, as subcontracted labor or third-party material purchases for customers increase relative to our own labor services, we expect the ratio of cost of services to revenue to increase. As we continue to bid and win larger contracts, our own labor services component could decrease. This is because the larger contracts typically are broader in scope and require more diverse capabilities resulting in more subcontracted labor with the potential for more third-party hardware and software purchases. In addition, we can face hiring challenges in staffing larger contracts. While these factors could lead to a higher ratio of cost of services to revenue, the economics of these larger jobs are nonetheless generally favorable because they increase income, broaden our revenue base, and have a favorable return on invested capital.

We have been able to build and effectively use what we refer to as a central services model. This central services model employs the use of centralized corporate services for marketing, business development, human resources, recruiting, finance and accounting, infrastructure and other core administrative services. This central services model generally allows us to reduce selling, general, and administrative expenses as a percentage of revenue as revenue grows organically and through selective acquisitions, thereby contributing to the expansion of our operating margins.

Depreciation and amortization expenses are affected by the level of our annual capital expenditures and the amount of identified intangibles related to acquisitions. We do not presently foresee significant changes in our capital expenditure requirements, which have averaged 2% or less of revenue over the last three fiscal years. As we continue to make selected strategic acquisitions, the amortization of identified intangibles assets may increase as a percentage of our revenue.

Our operating income, or revenue minus cost of services, selling, general and administrative expenses, and depreciation and amortization, and thus our operating margin, or the ratio of operating income to revenue, is driven by the mix and execution on our contracts, how we manage our costs, and the amortization charges resulting from acquisitions.

Our cash position is driven primarily by the level of net income, working capital in accounts receivable, capital expenditures and acquisition activities.

SELECTED KEY METRICS EVALUATED BY MANAGEMENT

We manage and assess the performance of our business by evaluating a variety of metrics. Selected key metrics are discussed below.

Revenue Growth

Our revenue growth is primarily organic, but has been augmented by selective strategic acquisitions. Our total year-over-year revenue growth rate was 44.6% for the three months and 41.3% for the six months ended

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December 31, 2005. Our organic revenue growth rate was 25.2% for the three months and 23.8% for the six months ended December 31, 2005, driven by building out existing accounts, broadening our client base, and leveraging cross selling opportunities with our recent acquisitions.

A part of our growth strategy includes pursuing acquisitions. In April 2005, we acquired Touchstone Consulting Group, Inc., or Touchstone, which provides strategic consulting services to the federal government. In July 2005, we acquired Galaxy which specializes in providing systems engineering, information technology, and tactical communication services and solutions to the federal government. In November 2005, we acquired Spectrum, which provides enterprise solutions to the federal government.

Contract Backlog

Future growth is dependent upon the strength of our target markets, our ability to identify opportunities, and our ability to successfully bid and win new contracts. Our success can be measured in part based upon the growth of our backlog. The following table summarizes our contract backlog:

	December 31, 2005	June 30, 2005
	(in millions)	
Backlog:		
Funded	$ 568.2	$ 453.2
Unfunded	2,603.8	2,296.9
Total backlog	$ 3,172.0	$ 2,750.1

Our total backlog of $3.2 billion as of December 31, 2005 represented a 15% increase over the June 30, 2005 backlog. We currently expect to recognize revenue during the remaining two quarters of fiscal 2006 from approximately 15% of our total backlog as of December 31, 2005.

Contract Mix

Contract profit margins are generally affected by the type of contract. We can generally earn higher profits on fixed-price and time-and-materials contracts than cost-plus-fee contracts. Our ability to further increase our operating margins is in part dependent on our ability to increase the amount of services delivered under fixed-price and time-and-materials contracts. The following table summarizes our historical contract mix, measured as a percentage of total revenue, for the periods indicated:

	Three Months Ended December 31,	Six Months Ended December 31,

	2005	2004	2005	2004
Cost-plus-fee	48%	46%	46%	44%
Time-and-materials	38	34	39	35
Fixed-price	14	20	15	21

While our government clients typically determine what type of contract will be awarded to us, where we have the opportunity to influence the type of contract awarded, we will pursue time-and-materials and fixed-price contracts for the reasons discussed above.

Operating Margin

Operating margin, or the ratio of operating income to revenue, is affected by the mix of our contracts and how we manage our costs. The operating margin improvements that we have shown over the last three completed fiscal years are primarily attributable to two factors: an increase in our direct labor utilization rate; and our ability

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to grow revenue at a faster rate than the costs necessary to support our central services model. The decrease in operating margin this fiscal year is primarily due to the compensation expense we are required to recognize under SFAS No. 123R. Additionally, we experienced an increase in third-party material purchases which generate lower profit.

Days Sales Outstanding

Days sales outstanding, or DSO, is a measure of how efficiently we manage the billing and collection of our accounts receivable, our most significant working capital requirement. DSO has improved for each of the last three completed fiscal years. For the three months ended December 31, 2005, we reported DSO of 80 days, an increase from 76 days for the three months ended September 30, 2005. The increase was primarily attributable to three factors: the learning curve associated with the implementation of a new accounting system in July 2005; the timing of certain large vendor purchases, which we were unable to bill and collect in the period; and the effect of the holidays on collections at the end of the period. We have a number of internal process initiatives underway that we believe will enable us to improve our DSO.

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RESULTS OF OPERATIONS

The following tables detail our condensed consolidated statements of operations and the period-over-period rate of change in each of the line items and express these items as a percentage of revenue, for the periods indicated.

	Three Months Ended December 31,			Six Months Ended December 31,		
	2005	2004	% Change	2005	2004	% Change
	(unaudited, in thousands)			(unaudited, in thousands)		
Revenue	$ 305,313	$ 211,212	44.6%	$ 586,008	$ 414,686	41.3%
Operating costs and expenses:						
Cost of services	231,004	155,942	48.1	441,244	307,488	43.5
Selling, general and administrative	45,446	29,846	52.3	89,103	59,122	50.7
Depreciation and amortization	4,643	3,155	47.2	8,653	6,037	43.3
Total operating costs and expenses	281,093	188,943	48.8	539,000	372,647	44.6
Operating income	24,220	22,269	8.8	47,008	42,039	11.8
Interest income, net	1,037	754	37.5	1,770	1,277	38.6
Income before taxes	25,257	23,023	9.7	48,778	43,316	12.6
Provision for income taxes	9,354	8,300	12.7	18,485	16,153	14.4
Net income	$ 15,903	$ 14,723	8.0%	$ 30,293	$ 27,163	11.5%

	(unaudited, as a percentage of revenue)		(unaudited, as a percentage of revenue)	
Revenue	100.0%	100.0%	100.0%	100.0%
Operating costs and expenses:				
Cost of services	75.7	73.8	75.3	74.1
Selling, general and administrative	14.9	14.1	15.2	14.3
Depreciation and amortization	1.5	1.5	1.5	1.5
Total operating costs and expenses	92.1	89.5	92.0	89.9
Operating income	7.9	10.5	8.0	10.1
Interest income, net	0.4	0.4	0.3	0.3
Income before taxes	8.3	10.9	8.3	10.4
Provision for income taxes	3.1	3.9	3.1	3.8
Net income	5.2%	7.0%	5.2%	6.6%

THREE MONTHS ENDED DECEMBER 31, 2005 COMPARED TO THREE MONTHS ENDED DECEMBER 31, 2004

Revenue

For the three months ended December 31, 2005, our revenue increased 44.6% to $305.3 million, from $211.2 million for the three months ended December 31, 2004. Organic revenue growth was 25.2% for the period, with the remainder of growth mostly attributable to our April 2005 and July 2005 acquisitions of Touchstone and Galaxy, respectively. Our organic growth has been driven in part by two large contracts. Our Federal Deposit Insurance Corporation, or FDIC, contract and our Advanced Information Technology Services, or AITS, contract with the National Guard were significant drivers of our revenue growth, generating approximately $18 million and $12 million, respectively, in additional revenue during the three months ended December 31, 2005 compared to the three months ended December 31, 2004.

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Cost of Services

For the three months ended December 31, 2005, cost of services increased 48.1% to $231.0 million, from $155.9 million for the three months ended December 31, 2004. This increase in cost of services was due primarily to the increased volume of services provided under the FDIC and AITS contracts, and the volume of services attributable to Touchstone s and Galaxy s existing contracts. As a percentage of revenue, cost of services increased to 75.7% in the three months ended December 31, 2005, from 73.8% in the three months ended December 31, 2004. This increase as a percentage of revenue was attributable primarily to an increased amount of direct material purchases made by us and delivered to clients in connection with our services. Typically, direct material purchases generate lower profit, which increases the ratio of cost of services to revenue. While this higher direct material content can drive our operating margin down, it generally has a positive impact on our earnings and return on invested capital.

Selling, General and Administrative Expenses

For the three months ended December 31, 2005, selling, general and administrative expenses increased 52.3% to $45.4 million, from $29.8 million for the three months ended December 31, 2004. As a percentage of revenue, selling, general and administrative expenses increased to 14.9% for the three months ended December 31, 2005, from 14.1% for the three months ended December 31, 2004. This increase as a percentage of revenue resulted primarily from the adoption of SFAS No. 123R on July 1, 2005. Under SFAS No. 123R, share-based payments not fully vested as of July 1, 2005 and those granted in the six months ended December 31, 2005 and future periods will be measured at estimated fair value and included in selling, general and administrative expenses over the appropriate earning period. For the three months ended December 31, 2005, we recognized approximately $3.3 million of compensation costs in accordance with SFAS No. 123R. Excluding the impact of SFAS No. 123R, selling, general and administrative expenses as a percentage of revenue were 13.8% and 14.1% for the three months ended December 31, 2005 and 2004, respectively.

Depreciation and Amortization

For the three months ended December 31, 2005, depreciation and amortization increased 47.2% to $4.6 million, from $3.2 million for the three months ended December 31, 2004. This increase in depreciation and amortization resulted primarily from the amortization associated with the identified intangibles recorded as a result of our acquisitions of Touchstone and Galaxy. As a percentage of revenue, depreciation and amortization was at 1.5% for both the three months ended December 31, 2005 and 2004.

Interest Income

For the three months ended December 31, 2005, interest income increased to $1.0 million, from $0.8 million for the three months ended December 31, 2004. This increase was due to a general rise in interest rates and one-time benefits from the interest earned on prior year tax refunds.

Income Taxes

For the three months ended December 31, 2005, our effective income tax rate increased to 37.0%, from 36.1% for the three months ended December 31, 2004. This increase was due primarily to additional services performed in higher taxing jurisdictions and higher one-time benefits from tax credits and refunds in the three months December 31, 2004 than in the three months ended December 31, 2005. The estimated effective tax rate is based on current tax law and current income and expense projections. The effective tax rate may be affected by future acquisitions, by changes in interest income from tax-advantaged municipal bond investments, or by the receipt of certain tax credits or refunds. Our effective income tax rate, excluding the impact of one-time events, is approximately 39%.

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SIX MONTHS ENDED DECEMBER 31, 2005 COMPARED TO SIX MONTHS ENDED DECEMBER 31, 2004

Revenue

For the six months ended December 31, 2005, our revenue increased 41.3% to $586.0 million, from $414.7 million for the six months ended December 31, 2004. Organic revenue growth was 23.8% for the period, with the remainder of growth mostly attributable to our April 2005 and July 2005 acquisitions of Touchstone and Galaxy, respectively. Our organic growth has been driven in part by several large contracts. Our FDIC, AITS, and United States Agency for International Development, or USAID, contracts were significant drivers of our revenue growth, generating approximately $27 million, $20 million, and $13 million, respectively, in additional revenue during the six months ended December 31, 2005 compared to the six months ended December 31, 2004.

Cost of Services

For the six months ended December 31, 2005, cost of services increased 43.5% to $441.2 million, from $307.5 million for the six months ended December 31, 2004. This increase in cost of services was due primarily to the increased volume of services provided under our FDIC, AITS, and USAID contracts, and the volume of services attributable to Touchstone s and Galaxy s existing contracts. As a percentage of revenue, cost of services increased to 75.3% in the six months ended December 31, 2005, from 74.1% in the six months ended December 31, 2004. This increase as a percentage of revenue was attributable primarily to an increased amount of direct material purchases made by us and delivered to clients in connection with our services.

Selling, General and Administrative Expenses

For the six months ended December 31, 2005, selling, general and administrative expenses increased 50.7% to $89.1 million, from $59.1 million for the six months ended December 31, 2004. As a percentage of revenue, selling, general and administrative expenses increased to 15.2% for the six months ended December 31, 2005, from 14.3% for the six months ended December 31, 2004. This increase as a percentage of revenue resulted primarily from the adoption of SFAS No. 123R on July 1, 2005. For the six months ended December 31, 2005, we recognized approximately $6.3 million of compensation costs in accordance with SFAS No. 123R. Excluding the impact of SFAS No. 123R, selling, general and administrative expenses as a percentage of revenue were 14.1% and 14.3% for the six months ended December 31, 2005 and 2004, respectively.

Depreciation and Amortization

For the six months ended December 31, 2005, depreciation and amortization increased 43.3% to $8.7 million, from $6.0 million for the six months ended December 31, 2004. This increase in depreciation and amortization resulted primarily from the amortization associated with the identified intangibles recorded as a result of our acquisitions of Touchstone and Galaxy. As a percentage of revenue, depreciation and amortization was at 1.5% for both the six months ended December 31, 2005 and 2004.

Interest Income

For the six months ended December 31, 2005, interest income increased to $1.8 million, from $1.3 million for the six months ended December 31, 2004. This increase was due to a general rise in interest rates and one-time benefits from the interest earned on a Virginia business license tax refund and other amended tax return refunds from previous years.

Income Taxes

For the six months ended December 31, 2005, our effective income tax rate increased to 37.9%, from 37.3% for the six months ended December 31, 2004. This increase was due primarily to additional services performed in higher taxing jurisdictions. The estimated effective tax rate is based on current tax law and current income and expense projections. The effective tax rate may be affected by future acquisitions, by changes in interest income from tax-advantaged municipal bond investments, or by the receipt of certain tax credits or refunds.

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SEASONALITY

In general, our quarterly operating margins have historically improved each quarter across our fiscal year. We typically experience a sequential decline in operating margin between our fiscal fourth quarter ending June 30 and our fiscal first quarter of the following year ending September 30. In the quarter ending September 30, we generally experience lower staff utilization rates. These lower utilization rates are attributable both to summer vacations and to increased proposal activity in connection with the end of the federal fiscal year. We typically transition a number of professional staff temporarily off of billable engagements to support this increased proposal activity. In addition, we tend to adopt budgets for selling, general and administrative expenses at the beginning of our fiscal year and allocate them roughly flat across the quarters. Our fourth quarter, which ends in June, is typically the strongest quarter as we benefit from the cumulative effect of hires during the year, growing revenue, and declining corporate selling, general and administrative expenses as a percentage of revenue.

LIQUIDITY AND CAPITAL RESOURCES

Our primary liquidity needs are to finance the costs of operations pending the billing and collection of accounts receivable, to acquire capital assets, to invest in research and development, and to make selective strategic acquisitions.

Since our May 2002 initial public offering, we have been able to meet all of our liquidity requirements, including all of our completed acquisitions, with cash generated from our operations. We expect the combination of cash flows from operations, our cash and cash equivalents, and our investments to meet our normal operating liquidity and capital expenditure requirements for at least the next twelve months.

Cash Flow

Accounts receivable represent our largest working capital requirement. We bill most of our clients monthly after services are rendered. Our operating cash flow is primarily affected by the overall profitability of our contracts, our ability to invoice and collect from our clients in a timely manner, and our ability to manage vendor payments. We continue to seek ways to improve our invoicing and collection procedures to improve cash flows from operations.

Net cash provided by operating activities was $17.2 million for the six months ended December 31, 2005 compared to $38.4 million for the six months ended December 31, 2004. The decrease was due to higher net working capital requirements, driven primarily by the increase in accounts receivable. The increase in the accounts receivable balance was primarily attributable to three factors: the learning curve associated with the implementation of a new accounting system in July 2005; the timing of certain large vendor purchases, which we were unable to bill and collect in the period; and the effect of holidays on collections at the end of the period. Net cash provided by operating activities was also impacted by the adoption of SFAS No. 123R, which resulted in the reclassification of excess tax benefits from operating cash flows to financing cash flows.

We used $96.3 million in net cash for investing activities in the six months ended December 31, 2005, compared to $17.7 million in the six months ended December 31, 2004. The higher amount of cash used for investing activities in the six months ended December 31, 2005 was primarily the result of our acquisitions of Galaxy and Spectrum in July 2005 and November 2005, respectively.

Net cash provided by financing activities was $15.7 million in the six months ended December 31, 2005, compared to $5.1 million in the six months ended December 31, 2004. On a recurring basis, our employees exercise stock options which results in the issuance of common stock. The higher amount of cash provided by financing activities in the six months ended December 31, 2005 was primarily the result of our adoption of SFAS No. 123R in July 2005. Under SFAS No. 123R, excess tax benefits from share-based payments are presented as sources of financing activity cash flows.

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Credit Facility and Borrowing Capacity

We do not currently maintain a credit facility as we expect our cash and cash equivalents and short-term investments, together with cash flow generated from operations, to meet our normal operating liquidity and capital expenditure requirements for the near future. Based on our profitability and the cash flow generated from our operating activities, we believe we have significant borrowing capacity. We maintain relationships with a number of banks who have communicated a willingness to extend credit to us on reasonable terms if the need for credit arises. In particular, it could be possible that we would be required to borrow in the event of a large acquisition or a series of smaller acquisitions in a relatively short period of time.

OFF-BALANCE SHEET ARRANGEMENTS

We do not have any off-balance sheet arrangements.

CONTRACTUAL OBLIGATIONS

The following table summarizes our contractual obligations as of December 31, 2005 that require us to make future cash payments. For contractual obligations, we included payments that we have an unconditional obligation to make. We did not include amounts already recorded on our balance sheet as liabilities at December 31, 2005.

	Payments due by period				
Contractual obligations:	**Total**	**Less than 1 year**	**Years 2 and 3**	**Years 4 and 5**	**After 5 Years**
			(in thousands)		
Operating lease obligations, net	$ 197,844	$ 27,254	$ 49,434	$ 40,571	$ 80,585
Total contractual obligations	$ 197,844	$ 27,254	$ 49,434	$ 40,571	$ 80,585

In the normal course of our business, we enter into agreements with subcontractors and vendors to provide products and services that we consume in our operations or that are delivered to our customers. These products and services are not considered unconditional obligations until the products and services are actually delivered, at which time we record a liability for our obligation.

DESCRIPTION OF CRITICAL ACCOUNTING POLICIES

The preparation of our financial statements in accordance with accounting principles generally accepted in the United States of America requires that we make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, as well as the disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates including those related to revenue recognition, doubtful accounts receivable, goodwill and other intangible assets, and other contingent liabilities. We base our estimates on our historical experience and various other factors that we believe are reasonable at the time the estimates are made. Actual results may differ significantly from our estimates under different assumptions or conditions. We believe the critical accounting policies requiring us to make significant estimates and judgments are revenue recognition, contract cost accounting, and accounting for acquisitions, including the identification of intangible assets and the ongoing impairment assessments of the intangible assets. If any of these estimates or judgments proves to be incorrect, our reported results could be materially affected.

Revenue Recognition

We recognize revenue when persuasive evidence of an arrangement exists, services have been rendered or goods delivered, the contract price is fixed or determinable, and collectibility is reasonably assured. We have a standard management process that we use to determine whether all required criteria for revenue recognition have been met. This standard management process includes a regular review of our contract performance. This review covers, among other matters, outstanding action items, progress against schedule, effort and staffing, requirements stability, quality, risks and issues, subcontract management, cost, commitments, and client satisfaction. During this review we determine whether the overall progress on a contract is consistent with the effort expended.

Absent evidence to the contrary, we recognize revenue as follows. Revenue on cost-plus-fee contracts is recognized to the extent of costs actually incurred plus a proportionate amount of the fee earned. We consider fixed fees under cost-plus-fee contracts to be earned in proportion to the allowable costs actually incurred in performance of the contract. Revenue on time-and-materials contracts is recognized based on the hours actually incurred at the negotiated contract billing rates, plus the cost of any allowable material costs and out-of-pocket expenses. Revenue on fixed-price contracts is generally recognized using the percentage-of-completion method of contract accounting. Unless it is determined as part of our regular contract performance review that overall progress on a contract is not consistent with costs expended to date, we determine the percentage completed based on the percentage of costs incurred to date in relation to total estimated costs expected upon completion of the contract. Revenue on fixed-price contracts pursuant to which a client pays us a specified amount to provide only a particular service for a stated time period, a so-called fee-for-service arrangement, is recognized as amounts become billable, assuming all other criteria for revenue recognition are met. We consider performance-based fees, including award fees, under any contract type to be earned when we can demonstrate satisfaction of performance goals, based upon historical experience, or we receive contractual notification from a client that the fee has been earned. Billings for hardware or software purchased by customers under one of our contracts where we do not act as a principal to the transaction are excluded from our revenue and cost of services, except to the extent of any fee or profit earned.

Contract revenue recognition inherently involves estimation. Examples of estimates include the contemplated level of effort to accomplish the tasks under contract, the cost of the effort, and an ongoing assessment of our progress toward completing the contract. From time to time, as part of our standard management processes, facts develop that require us to revise our estimated total costs or revenue. To the extent that a revised estimate affects contract profit or revenue previously recognized, we record the cumulative effect of the revision in the period in which the facts requiring the revision become known. The full amount of an anticipated loss on any type of contract is recognized in the period in which it becomes probable and can be reasonably estimated.

From time to time, we may proceed with work based on client direction prior to the completion and signing of formal contract documents. We have a formal review process for approving any such work. Revenue associated with such work is recognized only when it can be reliably estimated and realization is probable. We base our estimates on previous experiences with the client, communications with the client regarding funding status, and our knowledge of available funding for the contract or program.

We maintain reserves for doubtful accounts receivable that may arise in the normal course of business. Historically, we have not had significant write-offs of doubtful accounts receivable related to work we perform for the federal government. However, we do perform work on contracts and task orders where on occasion issues arise that lead to accounts receivable not being fully collected.

Contract Cost Accounting

As a contractor providing services primarily to the federal government, we categorize our costs as either direct or indirect and allowable or unallowable. Direct costs are those costs that are identified with specific contracts. These costs include labor, subcontractor and consultant services, third party materials we purchase under a contract, and other non-labor costs incurred in direct support of a contract. Indirect costs are those costs not identified with specific contracts. Rather, indirect costs are allocated to contracts in accordance with federal government rules and regulations. These costs typically include our selling, general, and administrative expenses,

fringe benefit expenses, and depreciation and amortization costs. Direct and indirect costs that are not allowable under the Federal Acquisition Regulation or specific contract provisions cannot be considered for reimbursement under our federal government contracts. We must specifically identify these costs to ensure we comply with these requirements. Our unallowable costs include a portion of our executive compensation, certain employee morale activities, certain types of legal and consulting costs, and the amortization of identified intangible assets, among others. A key element to our margin expansion has been our success at controlling indirect cost growth and unallowable costs. In addition, as we acquire and integrate new companies, we have been able to manage our indirect costs and improve operating margins by realizing opportunities for cost synergies and integrating the indirect support functions of acquired companies into our own.

Accounting for Acquisitions and Asset Impairment

The purchase price that we pay to acquire the stock or assets of an entity must be assigned to the net assets acquired based on the estimated fair market value of those net assets. The purchase price in excess of the estimated fair market value of the tangible net assets and separately identified intangible assets acquired represents goodwill. The purchase price allocation related to acquisitions involves significant estimates and management judgments that may be adjusted during the purchase price allocation period. The purchase price allocation period generally does not extend beyond one year from the acquisition date.

We must evaluate goodwill for impairment on an annual basis, or during any interim period if we have an indication that goodwill may be impaired. We assess the potential impairment of goodwill by comparing the carrying value of the assets and liabilities of our reporting unit to which goodwill is assigned to the estimated fair value of the reporting unit using a discounted cash flow approach. Each year during our third fiscal quarter, we perform our annual goodwill impairment analysis as of January 1. As of January 1, 2005, there was no indication of goodwill impairment as a result of our impairment analysis. If we are required to record an impairment charge in the future, it would have an adverse non-cash impact on our results of operations.

The estimated fair market value of identified intangible assets is amortized over the estimated useful life of the related intangible asset. We retain third-party valuation experts to assist us in determining the fair market values and useful lives of identified intangible assets. We evaluate these assets for impairment when events occur that suggest a possible impairment. Such events could include, but are not limited to, the loss of a significant client or contract, decreases in federal government appropriations or funding for specific programs or contracts, or other similar events. None of these events have occurred for the periods presented. We determine impairment by comparing the net book value of the asset to its future undiscounted net cash flows. If an impairment occurs, we will record an impairment expense equal to the difference between the net book value of the asset and its estimated discounted cash flows using a discount rate based on our cost of capital and the related risks of recoverability.

DESCRIPTION OF STATEMENT OF OPERATIONS ITEMS

The following is a description of certain line items of our statements of operations.

Revenue

Most of our revenue is generated on the basis of services provided to the federal government, either by our employees or by our subcontractors. In addition, the revenue we earn may include third-party hardware and software that we purchase and integrate when requested by the client as a part of the solutions that we provide to our clients.

Contract Types. When contracting with our government clients, we enter into one of three basic types of contracts: cost-plus-fee, time-and-materials, and fixed-price.

Cost-plus-fee contracts. Cost-plus-fee contracts provide for reimbursement of allowable costs and the payment of a fee, which is our profit. Cost-plus-fixed-fee contracts specify the contract fee in dollars.

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Cost-plus-award-fee contracts may provide for a base fee amount, plus an award fee that varies, within specified limits, based upon the client s assessment of our performance as compared to contractual targets for factors such as cost, quality, schedule, and performance.

Time-and-materials contracts. Under a time-and-materials contract, we are paid a fixed hourly rate for each direct labor hour expended and we are reimbursed for allowable material costs and out-of-pocket expenses. To the extent our actual direct labor and associated costs vary in relation to the fixed hourly billing rates provided in the contract, we will generate more or less profit, or could incur a loss.

Fixed-price contracts. Under a fixed-price contract, we agree to perform the specified work for a pre-determined price. To the extent our actual costs vary from the estimates upon which the price was negotiated, we will generate more or less than the anticipated amount of profit or could incur a loss. Some fixed-price contracts have a performance-based component, pursuant to which we can earn incentive payments or incur financial penalties based on our performance.

Cost of Services

Cost of services includes the direct costs to provide our services and business solutions to clients. The most significant of these costs are the salaries and wages, plus associated fringe benefits, of our employees directly serving clients. Cost of services also includes the costs of subcontractors and outside consultants, third-party materials, such as hardware or software that we purchase and provide to the client as part of an integrated solution, and any other direct costs, such as travel expenses incurred to support contract efforts.

Selling, General and Administrative Expenses

Selling, general and administrative expenses include the salaries and wages, plus associated fringe benefits, of our employees not performing work directly for clients. Among the functions covered by these costs are asset and facilities management, business development, research and development, contracts and legal, finance and accounting, executive and senior management, human resources, and information system support. Facilities-related costs are also included in selling, general and administrative expenses.

Depreciation and Amortization

Depreciation and amortization includes depreciation of computers and other equipment, the amortization of software we use internally, the amortization of leasehold improvements, and the amortization of identified intangible assets.

DEFINITION OF CERTAIN TERMS USED IN THIS MANAGEMENT S DISCUSSION AND ANALYSIS

The following is our definition of certain terms we have used in our discussion and analysis.

Backlog

We define backlog to include funded and unfunded orders for services under existing signed contracts, assuming the exercise of all priced options relating to those contracts.

We define funded backlog to be the portion of backlog for which funding currently is appropriated and obligated to us under a contract or other authorization for payment signed by an authorized purchasing authority, less the amount of revenue we have previously recognized. We define unfunded backlog as the total value of signed contracts, less funding to date. Unfunded backlog includes all contract options that have been priced but not yet funded. Unfunded backlog does not take contract ceiling value into consideration, nor does it include any estimate of future potential delivery orders that might be awarded under multiple award indefinite delivery/indefinite quantity, government-wide acquisition, or GWAC contracts, or our General Services Administration, or GSA schedule multiple award contract vehicles.

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Our backlog includes orders under contracts that in some cases extend for several years, with the latest expiring at the end of calendar year 2014.

We cannot guarantee that we will recognize any revenue from our backlog. The federal government has the prerogative to cancel any contract or delivery order at any time. Most of our contracts and delivery orders have cancellation terms that would permit us to recover all or a portion of our incurred costs and potential fees in such cases. Backlog varies considerably from time to time as current contracts or delivery orders are executed and new contracts or delivery orders under existing contracts are won.

Days Sales Outstanding

We calculate days sales outstanding, or DSO, by dividing the average accounts receivable at the beginning and end of the period, net of average billings in excess of revenue, by revenue per day in the period. Revenue per day for a quarter is determined by dividing total revenue by 90 days. Revenue per day for a year is determined by dividing total revenue by 360 days.

Direct Labor Utilization

We define direct labor utilization as the ratio of labor dollars worked on customer engagements to total labor dollars worked. We include every employee of the company in the computation. We exclude leave taken, such as vacation time or sick leave, so that we can understand how we are applying worked labor. Leave actually taken by our employees is largely beyond the control of management in the near term.

Organic Growth

We calculate organic growth by comparing our actual reported revenue in the current period, including revenue attributable to acquired companies, with adjusted revenue from the prior-year period. In arriving at prior-year period revenue, we include the revenue of acquired companies for the prior-year periods comparable to the current-year periods for which the acquired companies are included in our actual reported revenue. The resulting growth rate is intended to represent our organic, or non-acquisitive, growth year-over-year, including comparable period growth attributable to acquired companies. For illustrative purposes, we compute our three and six month organic growth rates of 25.2% and 23.8%, respectively as follows:

	Three Months Ended December 31,		
	2005	**2004**	**% Increase**
Revenue, as reported	$ 305,313	$ 211,212	44.6%
Plus: Revenue from acquired companies for the comparable prior year period		32,621	
Organic Revenue	$ 305,313	$ 243,833	25.2%

	Six Months Ended December 31,		
	2005	2004	% Increase
Revenue, as reported	$ 586,008	$ 414,686	41.3%
Plus: Revenue from acquired companies for the comparable prior year period		58,526	
Organic Revenue	$ 586,008	$ 473,212	23.8%

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RISK FACTORS

Risks Related To Our Business

We depend on contracts with U.S. federal government agencies, particularly clients within the Department of Defense and the National Guard, for substantially all of our revenue, and if our relationships with these agencies were harmed, our business would be threatened.

Revenue from contracts with U.S. federal government agencies accounted for 99% of our revenue for all periods presented herein. Revenue from contracts with clients in the Department of Defense and the National Guard accounted for 51%, 53%, 59%, and 58%, of our revenue for the six months ended December 31, 2005, fiscal 2005, fiscal 2004, and fiscal 2003, respectively. We believe that federal government contracts will continue to be the source of substantially all of our revenue for the foreseeable future. For this reason, any issue that compromises our relationship with agencies of the federal government in general, or within the Department of Defense and the National Guard in particular would cause serious harm to our business. Among the key factors in maintaining our relationships with federal government agencies and departments are our performance on individual contracts and delivery orders, the strength of our professional reputation, and the relationships of our key executives with client personnel. To the extent that our performance does not meet client expectations, or our reputation or relationships with one or more key clients are impaired, our revenue and operating results could be materially harmed.

Loss of our General Services Administration, or GSA, schedule contracts or our position as a prime contractor on one or more of our government-wide acquisition contracts, or GWACs, or our other multiple-award contracts would impair our ability to win new business.

We believe that one of the key elements of our success is our position as the holder of six GSA schedule contracts and as a prime contractor under four GWACs and more than 30 agency-specific indefinite delivery/indefinite quantity contracts. For the six months ended December 31, 2005 and the fiscal years ended June 30, 2005, 2004, and 2003, revenue from GSA schedule contracts, GWACs, and other indefinite delivery/indefinite quantity contracts accounted for approximately 75%, 77%, 83%, and 86%, respectively, of our revenue from federal government clients. As these types of contracts have increased in importance, we believe our position as a prime contractor on these contracts has become increasingly important to our ability to sell our services to federal government clients. If we were to lose our position on one or more of these contracts, we could lose revenue and our operating results could suffer.

The General Services Administration intends to combine two of its large GWACs, Millennia and ANSWER, under a new Alliant contract to be competitively awarded. We are presently a prime contractor on Millennia. If we do not win a position as a prime contractor on the new Alliant contract, we could lose revenue and our operating results could suffer.

The Department of Defense issued guidance providing that procurements of services that are not performance based or that are to be procured using a contract vehicle outside of the Department of Defense must be approved in advance. This could result in the Department of Defense limiting its future use of GWACs and GSA schedule contracts. Initiatives taken by the Department of Defense or other government agencies and departments, or the impact of the ongoing reorganization by GSA, could cause services we provide on existing contracts to migrate to contract vehicles on which we are not a prime contractor. Should this occur, our ability to compete for business from these organizations in the future may be harmed.

Orders under GSA schedule contracts, GWACs, and other indefinite delivery/indefinite quantity contracts typically have a one- or two-year initial term with multiple options that may be exercised by our government clients to extend the contract for successive periods of one or more years. We can provide no assurance that our clients will exercise these options.

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We may not receive the full amount of our backlog, which could harm our business.

Our backlog was approximately $3.2 billion as of December 31, 2005, of which $568.2 million was funded. We currently expect to recognize revenue during the last two quarters of fiscal year 2006 from approximately 15% of our total backlog as of December 31, 2005. Our backlog includes orders under contracts that in some cases extend for several years, with the latest expiring at the end of calendar year 2014. We define backlog to include both funded and unfunded orders for services under existing signed contracts, assuming the exercise of all priced options relating to those contracts. Congress often appropriates funds for our clients on a yearly basis, even though their contract with us may call for performance that is expected to take a number of years. As a result, contracts typically are only partially funded at any point during their term, and all or some of the work to be performed under the contracts may remain unfunded unless and until Congress makes subsequent appropriations and the procuring agency allocates funding to the contract. We define funded backlog to be the portion of backlog for which funding currently is appropriated and obligated to us under a contract or other authorization for payment signed by an authorized purchasing authority, less the amount of revenue we have previously recognized under the contract. We define unfunded backlog as the total value of signed contracts, less funding to date. Unfunded backlog includes all contract options that have been priced but not yet funded. Our estimate of the portion of the backlog as of December 31, 2005 from which we expect to recognize revenue during the last two quarters in fiscal year 2006 is likely to be inaccurate because the receipt and timing of any revenue is subject to various contingencies, many of which are beyond our control. In addition, we may never realize revenue from some of the engagements that are included in our backlog, and there is a higher degree of risk in this regard with respect to unfunded backlog. The actual accrual of revenue on engagements included in backlog may never occur or may change because a program schedule could change or the program could be cancelled, or a contract could be reduced, modified, or terminated early. If we fail to realize revenue from engagements included in our backlog as of December 31, 2005, our revenue and operating results for our 2006 fiscal year as well as future reporting periods may be materially harmed.

Contracts with state and local governments, other governments, international entities, or other organizations with special standing, could impose substantial additional liability and costs upon us.

As organizations seek to enhance their security, particularly state and local governments, other governments, international entities, and other organizations with special standing, such as the World Bank, we have the opportunity to expand our services beyond our core federal government client base. Contracting with such entities involves additional risks that may result in additional costs to us, including:

- the additional costs associated with evaluating, qualifying, and negotiating such opportunities;
- a requirement to understand and comply with the specific procurement laws and/or regulations of each individual state, locality, other government, international entity, or other party with special standing;
- the contractual acceptance of liability provisions that impose, for example, liquidated damages or other monetary damages in excess of the amount of services we provide, and in some cases are unlimited;
- the unavailability of certain protections that would typically be available under federal or common law; and
- an increased risk of additional costs associated with dispute resolution.

The loss of a key executive could impair our relationships with government clients and disrupt the management of our business.

We believe that our success depends on the continued contributions of the members of our senior management. We rely on our senior management to generate business and execute programs successfully. In addition, the relationships and reputation that many members of our senior management team have established and maintain with government personnel contribute to our ability to maintain good client relations and to identify new business opportunities. We do not have any employment agreements providing for a specific term of employment with any member of our senior management. The loss of any member of our senior management could impair our ability to identify and secure new contracts, to maintain good client relations, and otherwise to manage our business.

If we fail to attract and retain skilled employees, we might not be able to staff recently awarded engagements and sustain our profit margins and revenue growth.

We must continue to hire significant numbers of highly qualified individuals in fiscal 2006 who have advanced information technology and technical services skills and who work well with our clients in a government or defense-related environment. These employees are in great demand and are likely to remain a limited resource for the foreseeable future. If we are unable to recruit and retain a sufficient number of these employees, our ability to staff recently awarded engagements and to maintain and grow our business could be limited. We are operating in a tight labor market and, if it continues to tighten, we could be required to engage larger numbers of subcontractor personnel, which could cause our profit margins to suffer. In addition, some of our contracts contain provisions requiring us to commit to staff an engagement with personnel the client considers key to our successful performance under the contract. In the event we are unable to provide these key personnel or acceptable substitutions, the client may terminate the contract, and we may not be able to recover our costs.

If subcontractors on our prime contracts are able to secure positions as prime contractors, we may lose revenue.

For each of the past several years, as the GSA schedule contracts and GWACs have increasingly been used as contract vehicles, we have received substantial revenue from government clients relating to work performed by other information technology providers acting as subcontractors to us. In some cases, companies that have not held GSA schedule contracts or secured positions as prime contractors on GWACs have approached us in our capacity as a prime contractor, seeking to perform services as our subcontractor for a government client. Some of these providers that are currently acting as subcontractors to us may in the future secure positions as prime contractors upon renewal of the GSA schedule or GWAC contract. If one or more of our current subcontractors are awarded prime contractor status in the future, it could reduce or eliminate our revenue for the work they were performing as subcontractors to us. Revenue derived from work performed by our subcontractors represented approximately 32%, 32%, 30%, and 30% of our revenue for the six months ended December 31, 2005, fiscal 2005, fiscal 2004, and fiscal 2003, respectively.

We may not be successful in identifying acquisition candidates, and if we undertake acquisitions, they could be expensive, increase our costs or liabilities, or disrupt our business.

One of our strategies is to pursue growth through acquisitions. We have completed acquisitions of six complementary companies that provide services in one of our three target markets. We may not be able to identify suitable acquisition candidates at prices that we consider appropriate or to finance acquisitions on terms that are satisfactory to us. Additionally, we may not be able to identify acquisition candidates that align as closely with our existing business as the companies we have acquired previously. If we do identify an appropriate acquisition candidate, we may not be able to successfully negotiate the terms of the acquisition, finance the acquisition or, if the acquisition occurs, integrate the acquired business into our existing business. Negotiations of potential acquisitions and the integration of acquired business operations could disrupt our business by diverting management attention away from day-to-day operations. Acquisitions of businesses or other material operations may require additional debt or equity financing, resulting in leverage or dilution of ownership. We also may not realize cost efficiencies or synergies that we anticipated when selecting our acquisition candidates. In addition, we may need to record write-downs from future impairments of identified intangible assets and goodwill, which could reduce our future reported earnings. Acquisition candidates may have liabilities or adverse operating issues that we fail to discover through due diligence prior to the acquisition. Any costs, liabilities, or disruptions associated with any future acquisitions we may pursue could harm our operating results.

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If we are unable to successfully integrate companies we acquire into our business or to achieve the expected benefits of these acquisitions, our revenue and operating results may be impaired.

We acquired Touchstone, Galaxy, and Spectrum in April 2005, July 2005, and November 2005, respectively. If we are unable to successfully integrate Touchstone, Galaxy, or Spectrum or other companies we have acquired or may acquire in the future, our revenue and operating results could suffer. We may not be successful in achieving the anticipated synergies from these acquisitions, including our strategy of offering our services to existing clients of acquired companies to increase our revenue. The difficulties of integration may be increased by the necessity of coordinating geographically dispersed organizations, integrating personnel with disparate business backgrounds, and combining different corporate cultures. In addition, following the integration of acquired companies, we may experience increased attrition, including but not limited to key employees of acquired companies, which could reduce our future revenue.

We face intense competition from many competitors that have greater resources than we do, which could result in price reductions, reduced profitability, and loss of market share.

We operate in highly competitive markets and generally encounter intense competition to win contracts. If we are unable to successfully compete for new business or win recompetitions of existing business, our revenue growth and operating margins may decline. Many of our competitors are larger and have greater financial, technical, marketing, and public relations resources, larger client bases, and greater brand or name recognition than we do. Larger competitors include federal systems integrators such as Computer Sciences Corporation and Science Applications International Corporation, divisions of large defense contractors such as General Dynamics Corporation, Lockheed Martin Corporation, and Northrop Grumman Corporation, and consulting firms such as Accenture Ltd. and BearingPoint, Inc. Our larger competitors may be able to compete more effectively for very large-scale government contracts. Our larger competitors also may be able to provide clients with different or greater capabilities or benefits than we can provide in areas such as technical qualifications, past performance on large-scale contracts, geographic presence, the ability to provide a broader range of services without creating conflicts of interest or intra-organizational conflicts of interest, price, and the availability of key professional personnel. Our competitors also have established or may establish relationships among themselves or with third parties, including through mergers and acquisitions, to increase their ability to address client needs. Accordingly, it is possible that new competitors or alliances among competitors may emerge.

We derive significant revenue from contracts awarded through a competitive bidding process, which can impose substantial costs upon us, and we will lose revenue if we fail to compete effectively.

We derive significant revenue from federal government contracts that are awarded through a competitive bidding process. We expect that most of the government business we seek in the foreseeable future will be awarded through competitive bidding. Competitive bidding imposes substantial costs and presents a number of risks, including:

- the need to bid on engagements in advance of knowing the complete design or full requirements, which may result in unforeseen difficulties in executing the engagement and cost overruns;
- the substantial cost and managerial time and effort that we spend to prepare bids and proposals for contracts that may not be awarded to us;
- the need to accurately estimate the resources and costs that will be required to service any contract we are awarded;

the expense and delay that may arise if our competitors protest or challenge contract awards made to us pursuant to competitive bidding, and the risk that any such protest or challenge could result in the resubmission of bids on modified specifications, or in termination, reduction, or modification of the awarded contract; and

the opportunity cost of not bidding on and winning other contracts we might otherwise pursue.

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To the extent we engage in competitive bidding and are unable to win particular contracts, we not only incur substantial costs in the bidding process that would negatively affect our operating results, but we may be precluded from operating in the market for services that are provided under those contracts for a number of years. Even if we win a particular contract through competitive bidding, our profit margins may be depressed as a result of the costs incurred through the bidding process.

We may lose money on some contracts if we underestimate the resources we need to perform under the contract.

We provide services to the federal government under three types of contracts: cost-plus-fee, time-and-materials, and fixed-price. For the six months ended December 31, 2005, we derived 46%, 39%, and 15% of our revenue from cost-plus-fee, time-and-materials, and fixed-price contracts, respectively. Each of these types of contracts, to differing degrees, involves the risk that we could underestimate our cost of fulfilling the contract, which may reduce the profit we earn or lead to a financial loss on the contract.

- Under cost-plus-fee contracts, which are subject to a ceiling amount, we are reimbursed for allowable costs and paid a fee, which may be fixed or performance-based. However, if our costs exceed the ceiling or are not allowable under the terms of the contract or applicable regulations, we may not be able to recover those costs.
- Under time-and-materials contracts, we are reimbursed for labor at negotiated hourly billing rates and for certain expenses, and we assume the risk that our costs of performance may exceed the negotiated hourly rates.
- Under fixed-price contracts, we perform specific tasks for a fixed price. Compared to cost-plus-fee contracts and time-and-materials contracts, fixed-price contracts involve greater financial risk because we bear the impact of cost overruns.

For all three contract types, we bear varying degrees of risk associated with the assumptions we use to formulate our pricing for the work. To the extent our working assumptions prove inaccurate, we may lose money on the contract, which would adversely affect our operating results.

We may lose money or incur financial penalties if we agree to provide services under a performance-based contract arrangement.

We were awarded a blanket purchasing agreement, along with five other contractors, by the GSA that allows us to compete for work across the federal government. Under performance-based contract arrangements, we are paid only to the extent our customer actually realizes savings or achieves some other performance-based improvements that result from our services. In addition, we may also incur certain penalties. Performance-based contracts could impose substantial costs and risks, including:

- the need to accurately understand and estimate in advance the improved performance that might result from our services;
- the lack of experience both we and our primary customers have in using this type of contract arrangement; and
- the requirement that we incur significant expenses with no guarantee of recovering these expenses or realizing a profit in the future.

Even if we successfully execute a performance-based contract, our interim operating results and cash flows may be negatively affected by the fact that we may be required to incur significant up-front expenses prior to realizing any related revenue.

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We may lose revenue and our cash flow and profitability could be negatively affected if expenditures are incurred prior to final receipt of a contract.

We provide various professional services and sometimes procure equipment and materials on behalf of our government clients under various contract arrangements. From time to time, in order to ensure that we satisfy our clients delivery requirements and schedules, we may elect to initiate procurements in advance of receiving final authorization from the government client or a prime contractor. If our government or prime contractor clients requirements should change if the government or the prime contractor should direct the anticipated procurement to a contractor other than us or if the equipment or materials become obsolete or require modification before we are under contract for the procurement, our investment in the equipment or materials might be at risk if we cannot efficiently resell them. This could reduce anticipated revenue or result in a loss, negatively affecting our cash flow and profitability.

Our operating margins and operating results may suffer if cost-plus-fee contracts increase in proportion to our total contract mix.

In general, cost-plus-fee contracts are the least profitable of our contract types. Our government clients typically determine what type of contract will be awarded to us. Cost-plus-fee contracts accounted for 46%, 46%, 44%, and 43% of our revenue for the six months ended December 31, 2005, fiscal 2005, fiscal 2004 and fiscal 2003, respectively. To the extent that we enter into more or larger cost-plus-fee contracts in proportion to our total contract mix in the future, our operating margins and operating results may suffer. Although we have been awarded some large cost-plus-fee contracts, we are unable to predict the timing of any impact on our total contract mix or whether this will cause our operating margins to suffer in any future period.

If the volume of services we provide under fixed-price contracts decreases in total or as a proportion of our total business, if we underestimate our costs of performing fixed-price contracts, or if profit rates on these contracts decline, our operating margins and operating results may suffer.

We have historically earned higher profits on our fixed-price contracts relative to our other types of contracts. Fixed-price contracts accounted for 15%, 20%, 18%, and 20% of our revenue for the six months ended December 31, 2005, fiscal 2005, fiscal 2004 and fiscal 2003, respectively. If the volume of services we deliver under fixed-price contracts decreases, or shifts to other types of contracts, then our operating margins and operating results may suffer. Additionally, under fixed-price contracts we agree to perform specific work for a predetermined price. To the extent our actual costs exceed the estimates upon which the price was negotiated, we will generate less than the anticipated amount of profit or could incur a loss. Finally, we cannot assure you that we will be able to maintain our historic levels of profitability on fixed-price contracts in general.

If our subcontractors fail to perform their contractual obligations, our performance and reputation as a prime contractor and our ability to obtain future business could suffer.

As a prime contractor, we often rely significantly upon other companies as subcontractors to perform work we are obligated to deliver to our clients. Revenue derived from work performed by our subcontractors represented approximately 32%, 32%, 30%, and 30% of our revenue for the six months ended December 31, 2005, fiscal 2005, fiscal 2004 and fiscal 2003, respectively. A failure by one or more of our subcontractors to satisfactorily perform the agreed-upon services on a timely basis may compromise our ability to perform our obligations as a prime contractor. In some cases, we have limited involvement in the work performed by the subcontractor and may have exposure as a result of problems caused by the subcontractor. In extreme cases, performance deficiencies on the part of our subcontractors could result in a government client terminating our contract for default. A default termination could expose us to liability for the agency s costs of re-procurement, damage our reputation, and hurt our ability to compete for future contracts. Additionally, we may have disputes with our subcontractors that could impair our ability to execute our contracts as required.

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Unfavorable government audit results could force us to adjust previously reported operating results and could subject us to a variety of penalties and sanctions.

The federal government audits and reviews our performance on contracts, pricing practices, cost structure, and compliance with applicable laws, regulations, and standards. Like most large government contractors, our contracts are audited and reviewed on a continual basis by federal agencies, including the Defense Contract Management Agency and the Defense Contract Audit Agency. An audit of our work, including an audit of work performed by companies we have acquired or may acquire or subcontractors we have hired or may hire, could result in a substantial adjustment to our previously reported operating results.

In April 2004, the Defense Contract Audit Agency issued audit guidance suggesting that a Federal Acquisition Regulation billing clause in GSA schedule contracts prohibits billing subcontractor or third-party consultant hours using the GSA schedule hourly rates under time-and-material contracts, but rather provided that these hours must be billed at cost. This is contrary to previously issued instructions from GSA, and contrary to industry practice. If DCAA were to prevail with this new interpretation, cash we have already collected may need to be refunded, which could materially reduce profits and revenue on GSA schedule time-and-material orders.

If a government audit uncovers improper or illegal activities, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines, and suspension or debarment from doing business with U.S. federal government agencies. In addition, we could suffer serious harm to our reputation if allegations of impropriety were made against us, whether or not true. Although audits have been completed on our incurred contract costs through fiscal 2003, audits for costs incurred on work performed after fiscal 2003 have not yet been completed. In addition, non-audit reviews by the government may still be conducted on all our government contracts.

If we were suspended or debarred from contracting with the federal government generally, or any specific agency, if our reputation or relationship with government agencies were impaired, or if the government otherwise ceased doing business with us or significantly decreased the amount of business it does with us, our revenue and operating results would be materially harmed.

If we experience systems, service, or product failure, our reputation could be harmed and our clients could assert claims against us for damages or refunds.

We create, implement, and maintain information technology solutions, as well as sell products, that are often critical to our clients operations, including operations in war-zones and other hazardous environments. We have experienced and may in the future experience some systems and service failures, schedule or delivery delays, and other problems in connection with our work. If our solutions, services, products, including third party products we may resell to our clients, or other applications have significant defects or errors, are subject to delivery delays, or fail to meet our clients expectations, we may:

- lose revenue due to adverse client reaction;
- be required to provide additional services to a client at no charge;

receive negative publicity, which could damage our reputation and adversely affect our ability to attract or retain clients; or

suffer claims for substantial damages against us.

In addition to any costs resulting from product or service warranties, contract performance, or required corrective action, these failures may result in increased costs or loss of revenue if clients postpone subsequently scheduled work or cancel or fail to renew contracts.

While many of our contracts limit our liability for consequential damages that may arise from negligence in rendering services to our clients, these contractual provisions may not be legally sufficient to protect us if we are sued. In addition, our errors and omissions and product liability insurance coverage may not continue to be available on reasonable terms or in sufficient amounts to cover one or more large claims, or the insurer may disclaim coverage as to some types of future claims. As we continue to grow and expand our business into new areas, our insurance coverage may not be adequate. The successful assertion of any large claim against us could seriously harm our business. Even if not successful, these claims could result in significant legal and other costs, may be a distraction to our management, and may harm our reputation.

Our business commitments require our employees to travel to potentially dangerous places, which may result in injury to our employees.

Our business involves providing services that require our employees to operate in various countries around the world, including Iraq. These countries may be experiencing political upheaval or unrest, and in some cases war or terrorism. Senior level employees or executives may, on occasion, be part of the teams deployed to provide services in these countries. As a result, it is possible that certain of our employees or executives will suffer injury or bodily harm in the course of these deployments. It is also possible that we will encounter unexpected costs in connection with additional risks inherent with sending our employees to dangerous locations, such as increased insurance costs, as well as the repatriation of our employees or executives for reasons beyond our control.

Our failure to obtain and maintain necessary security clearances may limit our ability to perform classified work for government clients, which could cause us to lose business.

Some government contracts require us to maintain facility security clearances and require some of our employees to maintain individual security clearances. We have seen a recent increase in the number of clients requiring special security clearances and the types of clearances required. If our employees lose or are unable to timely obtain security clearances, or we lose a facility clearance, the government client can terminate the contract or decide not to renew it upon its expiration. As a result, to the extent we cannot obtain the required security clearances for our employees working on a particular contract, or we fail to obtain them on a timely basis, we may not derive the revenue anticipated from the contract, which could harm our operating results.

Security breaches in sensitive government systems could result in loss of clients and negative publicity.

Many of the systems we develop, install, and maintain involve managing and protecting information used in intelligence, national security, and other sensitive or classified government functions. A security breach in one of these systems could cause serious harm to our business, damage our reputation, and prevent us from being eligible for further work on sensitive or classified systems for federal government clients. We could incur losses from such a security breach that could exceed the policy limits under our insurance. Damage to our reputation or limitations on our eligibility for additional work resulting from a security breach in one of our systems could materially reduce our revenue.

Our quarterly operating results may fluctuate significantly as a result of factors outside of our control, which could cause the market price of our class A common stock to decline.

Our revenue and operating results could vary significantly from quarter to quarter. In addition, we cannot predict with certainty our future revenue or results of operations. As a consequence, our operating results may fall below the expectations of securities analysts and investors, which could cause the price of our class A common stock to decline. Factors that may affect our operating results include:

fluctuations in revenue earned on contracts;

commencement, completion, or termination of contracts during any particular quarter;

variable purchasing patterns under GSA schedule contracts, GWACs, and agency-specific indefinite delivery/indefinite quantity contracts;

providing services under a share-in-savings or performance-based contract;

additions and departures of key personnel;

strategic decisions by us or our competitors, such as acquisitions, divestitures, spin-offs, joint ventures, strategic investments, or changes in business strategy;

contract mix, the extent of use of subcontractors, and the level of third-party hardware and software purchases for customers;

changes in presidential administrations and senior federal government officials that affect the timing of technology procurement;

changes in policy or budgetary measures that adversely affect government contracts in general; and

the seasonality of our business.

Reductions in revenue in a particular quarter could lead to lower profitability in that quarter because a relatively large amount of our expenses are fixed in the short-term. We may incur significant operating expenses during the start-up and early stages of large contracts and may not receive corresponding payments or revenue in that same quarter. We may also incur significant or unanticipated expenses when contracts expire or are terminated or are not renewed. In addition, payments due to us from government agencies may be delayed due to billing cycles or as a result of failures of governmental budgets to gain Congressional and administration approval in a timely manner.

We depend on our intellectual property and our failure to protect it could enable competitors to market products and services with similar features that may reduce demand for our products.

Our success depends in part upon the internally developed technology, proprietary processes, and other intellectual property that we utilize to provide our services and incorporate in our products. If we are unable to protect our intellectual property, our competitors could market services or products similar to our services and products, which could reduce demand for our offerings. Federal government clients typically retain a perpetual, world-wide, royalty-free right to use the intellectual property we develop for them in any manner they deem appropriate, including providing it to our competitors in connection with their performance of other federal government contracts. We typically seek governmental authorization to re-use intellectual property developed for the federal government or to secure export authorization. Federal government clients typically grant contractors the right to commercialize software developed with federal funding. However, if we were to improperly use intellectual property even partially funded by the federal government, the federal government could seek damages or royalties from us, sanction us, or prevent us from working on future government contracts.

We may be unable to prevent unauthorized parties from attempting to copy or otherwise obtain and use our technology. Policing unauthorized use of our technology is difficult, and we may not be able to prevent misappropriation of our technology, particularly in foreign countries where the laws may not protect our intellectual property as fully as those in the United States. Others, including our employees, may compromise the trade secrets and other intellectual property that we own. Although we require our employees to execute non-disclosure and intellectual property assignment agreements and comply with related policies and procedures, these agreements may not be legally or practically sufficient to protect our rights. Litigation may be necessary to enforce our intellectual property rights, to protect our trade secrets, and to determine the validity and scope of the proprietary rights of others. Any litigation could result in substantial costs and diversion of resources, with no assurance of success.

We may be harmed by intellectual property infringement claims.

We may become subject to claims from our employees or third parties who assert that software and other forms of intellectual property that we use in delivering services and business solutions to our clients infringe upon intellectual property rights of such employees or third parties. Our employees develop much of the software and other forms of intellectual property that we use to provide our services and business solutions to our clients, but we also license technology from other vendors. If our vendors, our employees, or third parties assert claims that we or our clients are infringing on their intellectual property, we could incur substantial costs to defend those claims. In addition, if any of these infringement claims are ultimately successful, we could be required to:

- cease selling or using products or services that incorporate the challenged software or technology;
- obtain a license or additional licenses from our vendors or other third parties; or
- redesign our products and services that rely on the challenged software or technology.

Our employees may engage in misconduct or other improper activities, which could harm our business.

We are exposed to the risk that employee fraud or other misconduct could occur. Misconduct by employees could include intentional failures to comply with federal government procurement regulations, engaging in unauthorized activities, seeking reimbursement for improper expenses or falsifying time records. Employee misconduct could also involve the improper use of our clients sensitive or classified information, which could result in regulatory sanctions against us and serious harm to our reputation. It is not always possible to deter employee misconduct, and the precautions we take to prevent and detect this activity may not be effective in controlling unknown or unmanaged risks or losses, which could harm our business.

Activation of military and National Guard reserves could significantly reduce our revenue and profits.

Activation of military reserves, in connection with international conflicts or otherwise, could result in some clients and client contracting staff being activated into the military services. This could delay contract awards that might be in the evaluation or award process, which could in turn reduce our revenue until such time as our clients are able to complete the evaluation and award process, or could even result in the loss of the potential contract award.

As of December 31, 2005 we had approximately 130 employees who serve as reserves for a branch of the military or the National Guard. In the event of a significant call-up we will pay these employees the differential between their military pay and their salary for up to six months. Our standard practice in the absence of a significant call-up is to provide for up to two weeks of differential pay for military leave. To the extent those called for military duty are directly billable on our contracts, our revenue could be reduced. Additionally, our fringe benefit expenses would be increased by any differential payments, which could reduce our profits.

Risks Related To Our Industry

A reduction in the U.S. defense budget could result in a substantial decrease in our revenue.

Revenue from contracts with clients in the Department of Defense and the National Guard accounted for 51%, 53%, 59%, and 58% of our revenue for the six months ended December 31, 2005, fiscal 2005, fiscal 2004 and fiscal 2003, respectively. A decline in overall U.S. military expenditures could cause a decrease in our revenue and profitability. The reduction in the U.S. defense budget during the early 1990s caused some defense-related government contractors to experience decreased sales, reduced operating margins and, in some cases, net losses. Defense spending levels may not continue at present levels, and future levels of expenditures and authorizations for existing programs may decline, remain constant, or shift to agencies or programs in areas where we do not currently have contracts. A significant decline in defense expenditures, or a shift in expenditures away from agencies or programs that we support, could cause a material decline in our revenue.

A reduction in U.S. civil government agency budgets, including a reduction caused by the diversion of funding to support the war against terrorism or the reconstruction of Iraq, could result in a substantial decrease in our revenue.

Revenue from contracts with civil agency clients accounted for 48%, 46%, 40%, and 41% of our revenue for the six months ended December 31, 2005, fiscal 2005, fiscal 2004 and fiscal 2003, respectively. We expect

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civil agency clients will continue to represent a substantial portion of our future revenue. A decline in expenditures by civil agencies could cause a material decrease in our revenue and profitability. In particular, a shift of funds away from civil agencies to pay for programs within other agencies, for example the Department of Defense, to reduce federal budget deficits, or to fund tax reductions, could cause a material decline in our revenue. In particular, it is possible that funding for civil agencies may be diverted to support the ongoing war against terrorism, the reconstruction of Iraq, or other international conflicts.

Changes in the spending policies or budget priorities of the federal government could cause us to lose revenue.

We derived 99% of our revenue for all periods presented herein, from contracts with federal government agencies. We believe that contracts with federal government agencies and departments will continue to be the primary source of our revenue for the foreseeable future. Accordingly, changes in federal government fiscal or spending policies could directly affect our financial performance. Among the factors that could harm our federal government contracting business are:

- the curtailment of the federal government s use of technology services firms;
- a significant decline in spending by the federal government in general, or by specific departments or agencies in particular;
- a reduction in spending or shift of expenditures from existing programs to pay for an international conflict or related reconstruction efforts;
- a failure of Congress to pass adequate supplemental appropriations to pay for an international conflict, or to pay for the cost of related reconstruction efforts;
- reductions in federal government programs or requirements;
- the adoption of new laws or regulations that affect companies that provide services to the federal government;
- delays in the payment of our invoices by government payment offices;
- federal governmental shutdowns, such as the shutdown that occurred during the government s 1996 fiscal year, and other potential delays in the government appropriations process, such as federal agencies having to operate under a continuing funding resolution because of delays in Congressional budget appropriations; and
- general economic and political conditions.

These or other factors could cause federal government agencies and departments to reduce their purchases under contracts, to exercise their right to terminate contracts, or not to exercise options to renew contracts, any of which could cause us to lose revenue. We have substantial contracts in place with many federal departments and agencies, and our continued performance under these contracts, or award of additional contracts from these agencies, could be materially harmed by federal government spending reductions or budget cutbacks at these departments or agencies.

The failure by Congress to approve budgets on a timely basis for the federal agencies we support could delay or reduce spending and cause us to lose revenue.

On an annual basis, Congress must approve budgets that govern spending by each of the federal agencies we support. When Congress is unable to agree on budget priorities, and thus is unable to pass the annual budget on a timely basis, then Congress typically enacts a continuing resolution. A continuing resolution allows government agencies to operate at spending levels approved in the previous budget cycle. When government agencies must operate on the basis of a continuing resolution it may delay funding we expect to receive from clients on work we are already performing and will likely result in any new initiatives being delayed, and in some cases being cancelled.

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The adoption of new procurement laws or regulations could reduce the amount of services that are outsourced by the federal government and could cause us to lose future revenue.

New legislation, procurement regulations, or union pressure could cause federal agencies to adopt restrictive procurement practices regarding the use of outside information technology providers. For example, the American Federation of Government Employees, the largest federal employee union, strongly endorses legislation that may restrict the procedure by which services are outsourced to government contractors. If such legislation were to be enacted, it would likely reduce the amount of information technology services that could be outsourced by the federal government, which could materially reduce our future revenue.

The Office of Management and Budget process for ensuring government agencies properly support capital planning initiatives, including information technology investments, could reduce or delay federal information technology spending and cause us to lose revenue.

The Office of Management and Budget, or OMB, supervises spending by federal agencies, including enforcement of the Government Performance Results Act. This Act requires, among other things, that federal agencies make an adequate business justification to support capital planning initiatives, including all information technology investments. The factors considered by OMB include, among others, whether the proposed information technology investment is expected to achieve an appropriate return on investment, whether related processes are contemporaneously reviewed, whether inter-operability with existing systems and the capacity for these systems to share data across government has been considered, and whether existing off-the-shelf products are being utilized to the extent possible. If our clients do not adequately justify proposed information technology investments to the OMB, the OMB may refuse funding for their new or continuing information technology investments, and we may lose revenue as a result.

Federal government contracts contain provisions giving government clients a variety of rights that are unfavorable to us, including the ability to terminate a contract at any time for convenience.

Federal government contracts contain provisions and are subject to laws and regulations that provide government clients with rights and remedies not typically found in commercial contracts. These rights and remedies allow government clients, among other things, to:

- terminate existing contracts, with short notice, for convenience, as well as for default;
- reduce or modify contracts or subcontracts;
- terminate our facility security clearances and thereby prevent us from receiving classified contracts;
- cancel multi-year contracts and related orders if funds for contract performance for any subsequent year become unavailable;
- decline to exercise an option to renew a multi-year contract;
- claim rights in products, systems, and technology produced by us;

prohibit future procurement awards with a particular agency due to a finding of organizational conflict of interest based upon prior related work performed for the agency that would give a contractor an unfair advantage over competing contractors;

subject the award of GSA schedule contracts, GWACs, and other indefinite delivery/indefinite quantity contracts to protest by competitors, which may require the contracting federal agency or department to suspend our performance pending the outcome of the protest and may also result in a requirement to resubmit bids for the contract or in the termination, reduction, or modification of the awarded contract; and

suspend or debar us from doing business with the federal government or with a particular governmental agency.

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If a government client terminates one of our contracts for convenience, we may recover only our incurred or committed costs, settlement expenses, and profit on work completed prior to the termination. If a federal government client were to unexpectedly terminate, cancel, or decline to exercise an option to renew with respect to one or more of our significant contracts or suspend or debar us from doing business with government agencies, our revenue and operating results would be materially harmed.

Some government procurement offices have recently issued requests for proposals, or RFPs, stating that fees will not be permitted on subcontractors that are used on time-and-material orders issued under those contracts. If this prohibition is included in these future contract awards, and we subcontract a significant component of time and material orders issued under these contracts, this could reduce our profitability on future work.

Our failure to comply with complex procurement laws and regulations could cause us to lose business and subject us to a variety of penalties.

We must comply with laws and regulations relating to the formation, administration, and performance of federal government contracts, which affect how we do business with our government clients and may impose added costs on our business. Among the most significant regulations are:

- the Federal Acquisition Regulation, and agency regulations analogous or supplemental to the Federal Acquisition Regulation, which comprehensively regulate the formation, administration, and performance of government contracts, including provisions relating to the avoidance of conflicts of interest and intra-organizational conflicts of interest;

- the Truth in Negotiations Act, which requires certification and disclosure of all cost and pricing data in connection with some contract negotiations;

- the Procurement Integrity Act, which requires evaluation of ethical conflicts surrounding procurement activity and establishing certain employment restrictions for individuals who participate in the procurement process;

- the Cost Accounting Standards, which impose accounting requirements that govern our right to reimbursement under some cost-based government contracts;

- laws, regulations, and executive orders restricting the use and dissemination of information classified for national security purposes and the exportation of specified products, technologies, and technical data;

- laws surrounding lobbying activities a corporation may engage in and operation of a Political Action Committee established to support corporate interests; and

- compliance with antitrust laws.

If a government review or investigation uncovers improper or illegal activities, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, harm to our reputation, suspension of payments, fines, and suspension or debarment from doing business with federal government agencies. The government may in the future reform its procurement practices or adopt new contracting rules and regulations, including cost accounting standards, that could be costly to satisfy or that could impair our ability to obtain new contracts. Any failure to comply with applicable laws and regulations could result in contract termination, price or fee reductions, or suspension or debarment from contracting with the federal government, each of which could lead to a material reduction in our revenue.

Other Risks Related To Our Stock

A public market for our class A common stock has existed only for a limited period of time, and our stock price is volatile and could decline.

Prior to May 24, 2002, there was no public market for any class of our common stock. An active trading market for our class A common stock may not be sustained, which could affect your ability to sell your shares and could depress the market price of your shares.

The stock market in general, and the market for technology-related stocks in particular, has been highly volatile. As a result, the market price of our class A common stock is likely to be similarly volatile, and holders of our class A common stock may experience a decrease in the value of their stock, including decreases unrelated to our operating performance or prospects. The price of our class A common stock could be subject to wide fluctuations in response to a number of factors, including those listed in this Risk Factors section and others such as:

- our operating performance and the performance of other similar companies or companies deemed to be similar;
- actual or anticipated differences in our quarterly operating results;
- changes in our revenue or earnings estimates or recommendations by securities analysts;
- publication of research reports about us or our industry by securities analysts;
- additions and departures of key personnel;
- contract mix and the extent of use of subcontractors;
- strategic decisions by us or our competitors, such as acquisitions, consolidations, divestments, spin-offs, joint ventures, strategic investments, or changes in business strategy;
- federal government spending levels, both generally and by our particular government clients;
- the passage of legislation or other regulatory developments that adversely affect us or our industry;
- the failure by Congress to approve budgets on a timely basis;
- speculation in the press or investment community;
- changes in the government information technology services industry;
- changes in accounting principles;
- terrorist acts;
- general market conditions, including economic factors unrelated to our performance; and

military action related to international conflicts, wars, or otherwise.

In the past, securities class action litigation has often been instituted against companies following periods of volatility in their stock price. This type of litigation could result in substantial costs and divert our management s attention and resources.

Our chairman, whose interests may not be aligned with yours, controls our company, which could result in actions of which you or other stockholders do not approve.

As of January 31, 2006, Ernst Volgenau, our chairman, beneficially owned 257,156 shares of class A common stock and 12,050,736 shares of class B common stock, which represented approximately 65.0% of the combined voting power of our outstanding common stock. As of January 31, 2006, our executive officers and directors as a group beneficially owned an aggregate of 3,582,493 shares of class A common stock and 14,509,828 shares of class B common stock, which represented approximately 79.4% of the combined voting power of our outstanding common stock. As a result, these individuals acting together, or Dr. Volgenau acting alone, will be able to control the outcome of all matters that our stockholders vote upon, including the election of directors, amendments to our certificate of incorporation, and mergers or other business combinations. In addition, upon the death of Dr. Volgenau and the conversion of his class B common stock into class A common stock, William K. Brehm, a current director and the former chairman of our board of directors, if he survives Dr. Volgenau, would beneficially own all of the outstanding class B common stock and could exercise significant influence over corporate matters requiring stockholder approval. This concentration of ownership and voting power may also have the effect of delaying or preventing a change in control of our company and could prevent stockholders from receiving a premium over the market price if a change in control is proposed.

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Provisions of our charter documents and Delaware law may inhibit potential acquisition bids that you and other stockholders may consider favorable, and the market price of our class A common stock may be lower as a result.

There are provisions in our certificate of incorporation and by-laws that make it more difficult for a third party to acquire, or attempt to acquire, control of our company, even if a change in control was considered favorable by you and other stockholders. For example, our board of directors has the authority to issue up to 5,000,000 shares of preferred stock. The board of directors can fix the price, rights, preferences, privileges, and restrictions of the preferred stock without any further vote or action by our stockholders. The issuance of shares of preferred stock may delay or prevent a change in control transaction. As a result, the market price of our class A common stock and the voting and other rights of our stockholders may be adversely affected. This issuance of shares of preferred stock may result in the loss of voting control to other stockholders.

Our charter documents contain other provisions that could have an anti-takeover effect, including:

- the high-vote nature of our class B common stock;
- only one of the three classes of directors is elected each year;
- stockholders have limited ability to remove directors without cause;
- stockholders cannot take actions by written consent;
- stockholders cannot call a special meeting of stockholders; and
- stockholders must give advance notice to nominate directors or submit proposals for consideration at stockholder meetings.

In addition, we are subject to the anti-takeover provisions of Section 203 of the Delaware General Corporation Law, which regulates corporate acquisitions. These provisions could discourage potential acquisition proposals and could delay or prevent a change in control transaction. They could also have the effect of discouraging others from making tender offers for our class A common stock. These provisions may also prevent changes in our management.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Financial instruments that potentially subject us to credit risk consist primarily of cash equivalents, short- and long-term investments, and accounts receivable.

We believe that concentrations of credit risk with respect to cash equivalents and investments are limited due to the high credit quality of these investments. Our investment policy requires that investments be in direct obligations of the U.S. government, certain U.S. government sponsored entities, investments that are secured by direct or sponsored U.S. government obligations, or certain corporate or municipal debt obligations rated at least single-A or A-1/P-1, as applicable, by both Moody s Investor Service and Standard and Poors. Our policy does not allow investment in any equity securities or the obligations of any entity under review for possible downgrade by a major rating service to a debt rating below single-A.

Investments in both fixed and floating rate interest-earning instruments carry a degree of interest rate risk. Fixed securities may have their fair market value adversely impacted because of a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectations because of changes in interest rates or we may suffer losses in principal if forced to sell securities which have seen a decline in market value because of changes in interest rates. Investments are made in accordance with an investment policy approved by our board of directors. Under this policy, no investment securities may have maturities exceeding two years and the average duration of the portfolio cannot exceed nine months.

We believe that concentrations of credit risk with respect to accounts receivable are limited as they are primarily federal government receivables.

As of June 30, 2005 the fair value of our long-term investments was approximately $5.1 million, compared to the $5.2 million carrying value of those investments. As of December 31, 2005, the carrying value of our financial instruments approximated fair value.

Item 4. Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2005. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of December 31, 2005, our chief executive officer and chief financial officer concluded that as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended December 31, 2005 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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Part II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we are involved in various legal matters and proceedings concerning matters arising in the ordinary course of business. We currently believe that any ultimate liability arising out of these matters and proceedings will not have a material adverse effect on our financial position, results of operations or cash flows.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On December 9, 2005, we sold 78,020 shares of class A common stock to former shareholders of Spectrum Solutions Group for approximately $2.3 million, or $29.05 per share, in a private placement exempt from registration under the Act. No underwriters were involved in this sale of securities.

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

An Annual Meeting of Stockholders was held on October 28, 2005 (the Annual Meeting). The following matters were voted upon at the Annual Meeting:

Matter 1: To elect three Class I directors to serve until the 2008 Annual Meeting of Stockholders and until their successors are duly elected and qualified.

Matter 2: To ratify the selection by the Audit Committee of Deloitte & Touche LLP as the Company s independent auditors for the fiscal year ending June 30, 2006.

A summary of the voting for each director nominee and other matters voted upon at the Annual Meeting is as follows:

Nominee/Matter	For	Against or Withheld	Abstain	Broker Non-Votes
John W. Barter	181,371,490	3,730,286		

Steven A. Denning	180,994,288	4,107,488	
Miles R. Gilburne	182,922,226	2,179,550	
Matter 2	185,074,964	22,480	4,332

Item 5. Other Information

None

Item 6. Exhibits

Exhibit Number	Description
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
32.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the county of Fairfax, Virginia on the 2nd day of February, 2006.

SRA INTERNATIONAL, INC.

By: /s/ RENATO A. DIPENTIMA

Renato A. DiPentima

President and Chief Executive Officer

(Principal Executive Officer)

By: /s/ STEPHEN C. HUGHES

Stephen C. Hughes,

Executive Vice President, Chief Financial Officer and

Chief of Finance and Administration

(Principal Financial and Accounting Officer)

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