SRA INTERNATIONAL INC
Form 10-Q
May 03, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2007

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 Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
4300 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.

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 April 27, 2007, there were 42,766,106 shares outstanding of the registrant s class A common stock and 14,199,828 shares outstanding of the registrant s class B common stock.

SRA INTERNATIONAL, INC.

QUARTERLY REPORT ON FORM 10-Q FOR THE THREE MONTHS

AND NINE MONTHS ENDED MARCH 31, 2007

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Item 1. Financial Statements

SRA INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(in thousands)

Assets

	March 31, 2007	June 30, 2006
Current assets:		
Cash and cash equivalents	$ 163,905	$ 173,564
Short-term investments	85	9,834
Accounts receivable, net	257,741	266,160
Prepaid expenses and other	38,673	23,382
Deferred income taxes, current	2,022	4,839
Total current assets	462,426	477,779
Total property and equipment, net	38,083	37,462
Other assets:		
Goodwill	256,762	169,334
Identified intangibles, net	32,718	26,169
Deferred income taxes, noncurrent	6,904	3,462
Deferred compensation trust	8,226	7,768
Total other assets	304,610	206,733
Total assets	$ 805,119	$ 721,974

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

SRA INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(in thousands, except share and per share amounts)

Liabilities and Stockholders Equity

	March 31, 2007	June 30, 2006
Current liabilities:		
Accounts payable and accrued expenses	$ 115,405	$ 115,545
Accrued payroll and employee benefits	70,992	59,463
Billings in excess of revenue recognized	2,812	3,204
Total current liabilities	189,209	178,212
Long-term liabilities:		
Other long-term liabilities	12,163	10,465
Total long-term liabilities	12,163	10,465
Total liabilities	201,372	188,677
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; 43,423,220 and 42,158,048 shares issued as of March 31, 2007 and June 30, 2006; 42,711,794 and 41,403,312 shares outstanding as of March 31, 2007 and June 30, 2006	174	169
Class B common stock, par value $0.004 per share; 55,000,000 shares authorized; 14,199,828 and 14,459,828 shares issued and outstanding as of March 31, 2007 and June 30, 2006	57	58
Additional paid-in capital	297,964	274,552
Treasury stock, at cost	(6,045)	(6,302)
Retained earnings	311,597	264,820
Total stockholders equity	603,747	533,297
Total liabilities and stockholders equity	$ 805,119	$ 721,974

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

SRA INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(in thousands, except share and per share amounts)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006	Nine Months Ended March 31, 2007	Nine Months Ended March 31, 2006
Revenue	$ 317,586	$ 296,098	$ 942,665	$ 882,106
Operating costs and expenses:				
Cost of services	237,684	220,256	710,485	661,500
Selling, general and administrative	51,588	48,134	148,921	137,237
Depreciation and amortization	5,535	4,689	15,585	13,342
Total operating costs and expenses	294,807	273,079	874,991	812,079
Operating income	22,779	23,019	67,674	70,027
Interest income, net	1,173	826	4,487	2,596
Gain on sale of Mantas, Inc.			3,674	
Income before taxes	23,952	23,845	75,835	72,623
Provision for income taxes	8,979	9,062	29,058	27,547
Net income	$ 14,973	$ 14,783	$ 46,777	$ 45,076
Earnings per share:				
Basic	$ 0.26	$ 0.27	$ 0.83	$ 0.82
Diluted	$ 0.26	$ 0.26	$ 0.80	$ 0.78
Weighted-average shares:				
Basic	56,696,382	55,371,625	56,299,701	54,815,017
Diluted	58,383,305	57,947,723	58,261,389	57,627,037

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

SRA INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(in thousands)

	Nine Months Ended March 31, 2007	Nine Months Ended March 31, 2006
Cash flows from operating activities:		
Net income	$ 46,777	$ 45,076
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	15,585	13,342
Stock-based compensation	8,451	9,742
Deferred income taxes	(625)	602
Gain on sale of Mantas, Inc.	(3,674)	
Changes in assets and liabilities, net of the effect of acquisitions:		
Accounts receivable	18,382	(45,411)
Prepaid expenses and other	(15,054)	6,540
Accounts payable and accrued expenses	(4,483)	20,319
Accrued payroll and employee benefits	6,666	9,738
Billings in excess of revenue recognized	(392)	(2,860)
Other	2,589	(813)
Net cash provided by operating activities	74,222	56,275
Cash flows from investing activities:		
Capital expenditures	(10,289)	(7,782)
Sales and maturities of investments	9,749	20,696
Acquisition of Galaxy Scientific Corporation, net of cash acquired		(95,645)
Acquisition of Spectrum Solutions Group, net of cash acquired	(8,000)	(8,802)
Acquisition of RABA Technologies, net of cash acquired	(94,237)	
Proceeds from sale of Mantas, Inc.	3,674	
Net cash used in investing activities	(99,103)	(91,533)
Cash flows from financing activities:		
Issuance of common stock	8,057	11,053
Tax benefits of stock option exercises	6,004	11,711
Reissuance of treasury stock	1,245	3,990
Purchase of treasury stock	(84)	
Net cash provided by financing activities	15,222	26,754
Net decrease in cash and cash equivalents	(9,659)	(8,504)
Cash and cash equivalents, beginning of period	173,564	162,973
Cash and cash equivalents, end of period	$ 163,905	$ 154,469
Supplemental disclosures of cash flow information:		
Cash paid during the period:		
Income taxes	$ 30,820	$ 22,229
Cash received during the period:		

Interest	$ 4,590	$ 2,966
Income taxes	$ 438	$ 766

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

SRA INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Three Months and Nine Months Ended March 31, 2007 and 2006

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 nine months ended March 31, 2007 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 on Form 10-K for the year ended June 30, 2006.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157 (SFAS 157), Fair Value Measurements. SFAS 157 provides a new single authoritative definition of fair value and enhanced guidance for measuring the fair value of assets and liabilities. It requires additional disclosures related to the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS 157 is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently evaluating what effect, if any, the adoption of SFAS 157 will have on its financial position, results of operations, or cash flows.

In July 2006, the FASB issued Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes, and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating what effect the adoption of FIN 48 will have on its financial position, results of operations, or cash flows.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159 (SFAS 159), The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115. SFAS No. 159 permits entities to choose to measure eligible items at fair value at specified election dates and report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating what effect, if any, the adoption of SFAS 159 will have on its financial position, results of operations, or cash flows.

SRA INTERNATIONAL, INC. AND SUBSIDIARIES

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

Three Months and Nine Months Ended March 31, 2007 and 2006

Reclassifications

Certain reclassifications have been made to prior period balances to conform to the current period presentation.

2. Nature of Business:

SRA provides technology and strategic consulting 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 the nine months ended March 31, 2006. The United States Agency for International Development, as a client, accounted for approximately 10 percent of revenue for both the three and nine months ended March 31, 2006. No other client or client group accounted for more than 10 percent of revenue in the periods presented herein.

3. Earnings Per Share:

The Company calculates basic and diluted earnings per share (EPS) in accordance with SFAS No. 128, Earnings Per Share. Basic EPS is computed by dividing reported net income by the basic 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 to the effect of potential future exercises of stock options and vesting of restricted stock shares.

The Company currently has outstanding shares of class A and class B common stock. Our class A and class B common stock have equal dividend and liquidation rights. The only difference between the two classes is that holders of our class A common stock are entitled to one vote per share and holders of our class B common stock are entitled to ten votes per share. Each share of class B common stock is convertible at any time at the option of the holder into one share of class A common stock.

Basic and diluted EPS have been calculated using the if-converted method for class A common stock and the two-class method for class B common stock pursuant to SFAS 128. The two-class method is an earnings allocation formula that determines EPS for each class of common stock according to the weighted-average of dividends declared, outstanding shares per class and participation rights in undistributed earnings. The computation of EPS by applying the two-class method does not yield a different result than that provided under the if-converted method.

Undistributed earnings are calculated as follows (in thousands):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2007	2006	2007	2006
Net income	$ 14,973	$ 14,783	$ 46,777	$ 45,076
Less: dividends				
Undistributed earnings	$ 14,973	$ 14,783	$ 46,777	$ 45,076

SRA INTERNATIONAL, INC. AND SUBSIDIARIES

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

Three Months and Nine Months Ended March 31, 2007 and 2006

Weighted-average common shares outstanding are calculated as follows (in thousands):

	Three Months Ended March 31,				Nine Months Ended March 31,			
	2007		2006		2007		2006	
	Class A	Class B	Class A	Class B	Class A	Class B	Class A	Class B
Basic weighted-average common shares outstanding	42,463	14,233	40,801	14,571	41,932	14,368	39,918	14,897
Assumed conversion of class B shares	14,233		14,571		14,368		14,897	
Effect of potential exercise or vesting of stock-based awards	1,687		2,576		1,961		2,812	
Diluted weighted-average common shares outstanding	58,383	14,233	57,948	14,571	58,261	14,368	57,627	14,897

Stock options that could potentially dilute basic EPS in the future that were not included in the computation of diluted weighted-average common shares outstanding, because to do so would have been antidilutive, were 1,981,602 and 1,308,090 for the three months ended March 31, 2007 and 2006, respectively and 1,760,889 and 1,222,421 for the nine months ended March 31, 2007 and 2006, respectively.

Basic and diluted EPS are calculated as follows (in thousands, except per share amounts):

	Three Months Ended March 31,				Nine Months Ended March 31,			
	2007		2006		2007		2006	
	Class A	Class B	Class A	Class B	Class A	Class B	Class A	Class B
Basic								
Weighted-average shares outstanding	42,463	14,233	40,801	14,571	41,932	14,368	39,918	14,897
Divided by: Total weighted-average shares outstanding (class A and class B)	56,696	56,696	55,372	55,372	56,300	56,300	54,815	54,815
Multiplied by: Undistributed earnings	$ 14,973	$ 14,973	$ 14,783	$ 14,783	$ 46,777	$ 46,777	$ 45,076	$ 45,076
Subtotal	$ 11,214	$ 3,759	$ 10,893	$ 3,890	$ 34,839	$ 11,938	$ 32,826	$ 12,250
Divided by: Weighted-average shares outstanding	42,463	14,233	40,801	14,571	41,932	14,368	39,918	14,897
Earnings per share	$ 0.26	$ 0.26	$ 0.27	$ 0.27	$ 0.83	$ 0.83	$ 0.82	$ 0.82
Diluted								
Weighted-average shares outstanding	58,383	14,233	57,948	14,571	58,261	14,368	57,627	14,897
Divided by: Total weighted-average shares outstanding (class A and class B)	58,383	58,383	57,948	57,948	58,261	58,261	57,627	57,627
Multiplied by: Undistributed earnings	$ 14,973	$ 14,973	$ 14,783	$ 14,783	$ 46,777	$ 46,777	$ 45,076	$ 45,076
Subtotal	$ 14,973	$ 3,650	$ 14,783	$ 3,717	$ 46,777	$ 11,536	$ 45,076	$ 11,652
Divided by: Weighted-average shares outstanding	58,383	14,233	57,948	14,571	58,261	14,368	57,627	14,897
Earnings per share	$ 0.26	$ 0.26	$ 0.26	$ 0.26	$ 0.80	$ 0.80	$ 0.78	$ 0.78

SRA INTERNATIONAL, INC. AND SUBSIDIARIES

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

Three Months and Nine Months Ended March 31, 2007 and 2006

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 were 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 6,353,463 shares of class A common stock were reserved for issuance pursuant to the automatic increase feature of the 2002 plan through July 1, 2006. 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 determines 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

Effective July 1, 2005, the Company adopted SFAS No. 123 (revised 2004), Share-Based Payment, which requires that compensation costs related to share-based payment transactions be recognized in financial statements. The Company applied the modified prospective method under which compensation costs for all awards granted after the date of adoption and the unvested portion of previously granted awards outstanding at the date of adoption are 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. The Company s restricted stock awards are considered nonvested share awards as defined under SFAS No. 123R.

As a result of adopting SFAS No. 123R, the Company recorded $2.5 million and $3.2 million of stock-based compensation expense in its statement of operations for the three months ended March 31, 2007 and 2006, respectively, and $8.5 million and $9.7 million of stock-based compensation for the nine months ended March 31, 2007 and 2006, respectively. This stock-based compensation expense reduced basic earnings per share by $0.03 for both the three months ended March 31, 2007 and 2006, and reduced diluted earnings per share by $0.02 and $0.03 for the three months ended March 31, 2007 and 2006, respectively. This stock-based compensation expense reduced both basic and diluted earnings per share by $0.09 and $0.11 for the nine months ended March 31, 2007 and 2006, respectively.

Fair Value Determination

The fair value concepts were not changed significantly in SFAS No. 123R; however, in adopting this Standard, companies were required to choose among alternative valuation models and amortization assumptions.

SRA INTERNATIONAL, INC. AND SUBSIDIARIES

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

Three Months and Nine Months Ended March 31, 2007 and 2006

The Company 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 options with 10-year and 15-year terms. The following weighted-average assumptions were used for option grants during the nine months ended March 31, 2007 and 2006:

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 was 31 percent and 32 percent for the nine months ended March 31, 2007 and 2006, respectively.

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 was five years for both the nine months ended March 31, 2007 and 2006.

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 was 4.8 percent and 4.2 percent during the nine months ended March 31, 2007 and 2006, respectively.

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.

Stock Compensation Expense

In accordance with SFAS No. 123R, the Company estimates forfeitures and is recognizing compensation expense only for those share-based awards that are expected to vest. SFAS No. 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Our estimate of the forfeiture rate is based primarily upon historical experience of employee turnover.

The Company recorded $2.5 million and $3.2 million of stock-based compensation expense for the three months ended March 31, 2007 and 2006, respectively, and $8.5 million and $9.7 million for the nine months ended March 31, 2007 and 2006, respectively. The lower stock-based compensation expense reflects adjustments to account for the forfeitures of certain share-based awards in excess of what was estimated at the time of grant.

As of March 31, 2007, there was $22.6 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 13 months.

Stock Option Activity

The Company granted stock options to purchase 420,802 and 1,623,510 shares of class A common stock at a weighted-average exercise price of $25.32 and $34.64 per share based on the fair value of class A common stock

SRA INTERNATIONAL, INC. AND SUBSIDIARIES

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

Three Months and Nine Months Ended March 31, 2007 and 2006

on the date of grant during the nine months ended March 31, 2007 and 2006, respectively. The Black-Scholes-Merton weighted-average value per share of options granted was $9.26 and $12.32 per share during the nine months ended March 31, 2007 and 2006, respectively. Using the Black-Scholes-Merton model, the total expected value of the options granted for the nine months ended March 31, 2007 and 2006 was $3.5 million and $18.1 million, respectively. The options vest at the rate of 25 percent per year over four years, beginning on the date of grant, and expire ten years from the grant date.

The following table summarizes stock option activity for the nine months ended March 31, 2007:

	Number of Shares	Weighted-Average Exercise Price	Aggregate Intrinsic Value (in thousands)
Shares under option, July 1, 2006	7,666,784	$ 18.00	$ 80,365
Options granted	420,802	25.32	
Options exercised	(996,849)	7.12	18,792
Options cancelled and expired	(451,486)	29.34	984
Shares under option, March 31, 2007	6,639,251	$ 19.33	$ 49,615
Options exercisable at March 31, 2007	4,105,213	$ 14.55	$ 44,913

The aggregate intrinsic value calculated in the above table excludes the effect of antidilutive shares.

Information with respect to stock options outstanding and stock options exercisable at March 31, 2007 was as follows:

Range of Exercise Price		Options Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price
$ 3.17	$ 5.07	1,289,276	6.9 years	$ 4.10
$10.85	$16.80	1,824,967	8.4	14.35
$19.39	$25.11	1,877,036	7.6	21.70
$27.89	$35.40	1,647,972	8.3	34.06
		6,639,251		

Range of Exercise Price		Options Exercisable	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price
$ 3.17	$ 5.07	1,289,276	6.9 years	$ 4.10
$10.85	$16.80	1,557,317	8.7	13.99

$19.39	$25.11	768,180	7.2	20.92
$27.89	$35.40	490,440	8.0	33.84
		4,105,213		

During the nine months ended March 31, 2007 and 2006, the Company also granted 152,537 and 34,750 shares of restricted stock at a weighted-average grant date fair market value of $26.21 and $30.10 per share, respectively. These shares vest at the rate of 25 percent per year over four years.

SRA INTERNATIONAL, INC. AND SUBSIDIARIES

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

Three Months and Nine Months Ended March 31, 2007 and 2006

The following table summarizes restricted stock activity for the nine months ended March 31, 2007:

	Number of Shares	Weighted-Average Grant Date Value
Nonvested restricted shares at July 1, 2006	44,450	$ 27.75
Restricted shares granted	152,537	26.21
Restricted shares vested	(13,126)	27.11
Restricted shares forfeited	(12,910)	25.56
Nonvested restricted shares at March 31, 2007	170,951	$ 26.65

As of March 31, 2007 there were 6,526,418 shares of class A common stock reserved for issuance under the 2002 Stock Incentive Plan.

Employee Stock Purchase Plan

The Company maintains the SRA International, Inc. 2004 Employee Stock Purchase Plan (ESPP) and has reserved 500,000 shares for issuance thereunder. The ESPP was available to all eligible employees beginning on January 1, 2005. The ESPP permits eligible employees to purchase class A common stock, through payroll deductions of up to 15% of the employee s compensation, at a price equal to 100% of the average of the high and low price of the common stock on the last day of each offering period. Under the ESSP, employees purchased 11,609 shares and 35,159 shares for the three and nine months ended March 31, 2007, respectively.

5. Accounts Receivable:

Accounts receivable, net as of March 31, 2007 and June 30, 2006, consisted of the following (in thousands):

	March 31, 2007	June 30, 2006
Billed and billable, net of allowance of $3,711 as of March 31, 2007 and $1,614 as of June 30, 2006	$ 227,063	$ 242,259
Unbilled:		
Retainages	4,784	5,347
Revenue recorded in excess of milestone billings on fixed-price contracts	13,436	7,210
Revenue recorded in excess of contractual authorization, billable upon receipt of contractual amendments/documents	14,004	13,079
Allowance for unbillable amounts	(1,546)	(1,735)
Total unbilled	30,678	23,901
Total accounts receivable	$ 257,741	$ 266,160

The billable receivables included in the billed and billable line item above represent primarily revenue earned in the final month of the reporting period that 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 March 31, 2007 are expected to be billed and collected within one year except for approximately $1.6 million related to a portion of retainages.

SRA INTERNATIONAL, INC. AND SUBSIDIARIES

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

Three Months and Nine Months Ended March 31, 2007 and 2006

The Company may proceed with work based on client direction prior to the receipt of formal contract funding documents. Revenue associated with such work is recognized only when it can be reliably estimated and realization is probable. Two contracts account for approximately $5.8 million of the unbilled receivables balance related to revenue recorded in excess of contractual authorization as of March 31, 2007. Approximately $2.7 million of the balance related to these two contracts was funded subsequent to March 31, 2007 and the Company believes, based on communications regarding funding status and past experiences with these clients, it is probable that the remaining funding will be received.

6. Commitments and Contingencies:

Government Contracting

Payments to the Company on cost-plus-fee contracts are provisional and are subject to adjustment upon audit by the Defense Contract Audit Agency. Audits through June 30, 2005 have been completed. In the opinion of management, audit adjustments that may result from audits for periods after June 30, 2005 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, the Company 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.

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 RABA Technologies, LLC:

In October 2006, the Company completed its acquisition of RABA Technologies, LLC, or RABA, a provider of high-end technical services to the national security and intelligence communities. RABA s services include software development, systems integration and operational support. The Company acquired RABA for approximately $95.3 million, net of acquisition costs, from cash on hand. Approximately $11.4 million of the purchase price was allocated to identified intangibles and approximately $79.4 million to goodwill. The purchase price allocation involves management judgments and estimates which may be adjusted during the purchase price allocation period, but generally not beyond one year from the acquisition date.

If certain milestones are met, an additional purchase price payment of up to $5.0 million will be paid to the former stockholders of RABA. If paid, this contingent payment will result in additional goodwill in fiscal year 2009.

Pursuant to the requirements of SFAS No. 141 Business Combinations, 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.

SRA INTERNATIONAL, INC. AND SUBSIDIARIES

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

Three Months and Nine Months Ended March 31, 2007 and 2006

8. Gain on Sale of Mantas, Inc.:

In October 2006, i-flex solutions completed its acquisition of Mantas, Inc., of which the Company was a shareholder. The Company s portion of the net sale proceeds was approximately $4.4 million, including a portion to be held in escrow. The Company recognized a total pre-tax gain of approximately $3.7 million in the three months ended December 31, 2006. The remaining amount held in escrow will be recognized as a gain upon the release of funds pursuant to the terms of the escrow agreement.

9. Acquisition of Spectrum Solutions Group, Inc.:

In November 2005, the Company acquired Spectrum Solutions Group, Inc., or Spectrum. The Company made initial payments to Spectrum of approximately $9.7 million at closing. The Company agreed to make additional purchase price payments contingent upon the achievement of certain milestones by Spectrum. In January 2007, the Company paid former stockholders of Spectrum $8.0 million in additional purchase price. This additional payment resulted in an $8.0 million addition to goodwill on the balance sheet as of March 31, 2007. A final additional purchase price payment, if certain milestones are met, will be paid to the former stockholders of Spectrum in the quarter ending September 30, 2008.

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. 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 are a leading provider of technology and strategic consulting services and solutions to the federal government. We offer a broad range of services that spans the information technology life-cycle: strategic consulting; systems design, development, and integration; and outsourcing and managed services. In addition, to address recurring client needs, we develop business solutions for contingency and disaster response planning, information assurance, business intelligence, privacy protection, enterprise architecture, infrastructure management, and wireless integration. We provide services in three target markets: national security, civil government, and health care and public health. Our largest market, national security, includes the Department of Defense, the National Guard, the Department of Homeland Security, the intelligence agencies, and other federal organizations with homeland security missions.

Since our founding in 1978 we have derived substantially all of our revenue from services provided to federal government clients. Although the federal information technology market is currently facing challenges as a result of a shift in expenditures to pay for the war against terrorism and other international conflicts, we believe that the federal government s spending on information technology will continue to increase over the next several years. According to the *Federal IT Market Forecast, FY 2006-FY 2011* report published by INPUT, an independent federal government market research firm, the contracted portion of federal government spending on information technology is forecasted to grow at an annual rate of 5.0% from $63.3 billion in federal fiscal year 2006 to $80.5 billion in federal fiscal year 2011.

In the near term, we face challenges due to the current business environment. First, the Department of Defense continues to divert funding away from certain information technology initiatives to support the war against terrorism and the reconstruction of Iraq. Second, all civil agencies are operating under a continuing resolution through the end of the government s fiscal year ending September 30, 2007, limiting spending for most agencies to the fiscal 2006 level. The resulting budget tightness has slowed industry growth. As growth has slowed in these areas of our market, we have experienced pricing pressure on new business opportunities. Increased competition, combined with the shortage of experienced contracting staff among government agencies, has increased the frequency of contract protests, which has in turn caused delays in many new awards. Additionally, it is difficult to hire and retain highly qualified individuals who have advanced technology and technical services skills and who work well with our clients in a government environment, especially those with security clearances.

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.

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 may include 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 earning 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. 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 materials, 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 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 earnings, 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 central services for marketing, business development, human resources, recruiting, finance and accounting, infrastructure and other core administrative services. This central services model allows us to keep selling, general and administrative expenses low as a percentage of revenue as revenue grows organically and through selective acquisitions, thereby contributing to growth in operating income.

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 been approximately 2.0% or less of revenue over the last three fiscal years. As we continue to make selected strategic acquisitions, the amortization of identified intangible 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 organic growth has been augmented by selective strategic acquisitions. Our total year-over-year revenue growth rate was 7.3% for the three months and 6.9% for the nine months ended March 31, 2007.

A part of our growth strategy includes pursuing acquisitions. Through the third quarter of fiscal year 2007 we completed the following acquisitions:

Acquisition	Strategic Value	Closing Date	Purchase Price (in millions)
The Marasco Newton Group, Ltd.	Environment	January 4, 2002	$ 16.2
Adroit Systems, Inc.	Command and Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance (C4ISR)	January 31, 2003	38.3
ORION Scientific Systems	Counterterrorism	January 30, 2004	34.7
Touchstone Consulting Group, Inc.	Strategic Consulting	April 21, 2005	37.0
Galaxy Scientific Corporation	Command and Control, Communications, Computers, Intelligence (C4I)	July 1, 2005	98.7
Spectrum Solutions Group, Inc.	Enterprise Resource Planning	November 2, 2005	17.7
Mercomms Unlimited, Inc.	Maritime and Defense Communications	April 10, 2006	0.6
RABA Technologies, LLC	Intelligence	October 25, 2006	95.3

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:

	March 31, 2007	June 30, 2006
	(in millions)	
Backlog:		
Funded	$ 672.8	$ 512.8
Unfunded	2,830.6	2,748.8
Total backlog	$ 3,503.4	$ 3,261.6

Our total backlog of $3.5 billion as of March 31, 2007 represented a 7.4% increase over the June 30, 2006 backlog. Total backlog decreased by approximately 6.0% from December 31, 2006 due to lower contract awards in the three months ended March 31, 2007. We currently expect to recognize revenue during the fourth quarter of fiscal 2007 from approximately 8% of our total backlog as of March 31, 2007.

Our backlog includes orders under contracts that in some cases extend for several years, with the latest expiring during calendar year 2016.

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. Our estimate of the portion of the backlog as of March 31, 2007 from which we expect to recognize revenue in the fourth quarter of fiscal 2007 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. Finally, the amount of revenue we expect to realize under a particular engagement included in backlog may change because a program schedule could change or the program could be cancelled, or a contract could be reduced, modified, or terminated early.

Contract Mix

Contract profit margins are generally affected by the type of contract. We can typically earn higher profits on fixed-price and time-and-materials contracts than cost-plus-fee contracts. Thus, an important part of growing our operating income is 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 March 31,		Nine Months Ended March 31,	
	2007	**2006**	**2007**	**2006**
Cost-plus-fee	41%	44%	45%	45%
Time-and-materials	44	42	41	40
Fixed-price	15	14	14	15

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 try to 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. Our operating margins were 7.2% and 7.9% for the nine months ended March 31, 2007 and 2006, respectively. The decrease in operating margin for the nine months ended March 31, 2007 is primarily attributable to increased revenue from third-party material purchases which typically generate lower profit. Additionally, the amortization associated with identified intangibles recorded as a result of our acquisition of RABA, reduced operating margin in the nine months ended March 31, 2007.

Headcount and Labor Utilization

Because most of our revenue derives from services delivered by our employees, our ability to hire new employees and deploy them on direct-billable jobs is critical to our success. The market for highly qualified personnel with security clearances remains very tight. Therefore, we closely monitor hiring success, attrition trends, and direct labor utilization. The following table represents our headcount and our direct labor utilization:

	Three Months Ended March 31, 2007	Year Ended June 30, 2006
Headcount	5,213	4,975
Direct labor utilization	79.0%	78.5%

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. Accounts receivable represents the most significant asset we report on our balance sheet. For the three months ended March 31, 2007, we reported DSO of 77 days, an increase from 76 days reported for the three months ended December 31, 2006. We have a number of internal process initiatives underway that we believe will enable us to improve our invoicing and collection of accounts receivable.

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 March 31,			Nine Months Ended March 31,		
	2007	2006	% Change	2007	2006	% Change
	(unaudited, in thousands)			(unaudited, in thousands)		
Revenue	$ 317,586	$ 296,098	7.3%	$ 942,665	$ 882,106	6.9%
Operating costs and expenses:						
Cost of services	237,684	220,256	7.9	710,485	661,500	7.4
Selling, general and administrative	51,588	48,134	7.2	148,921	137,237	8.5
Depreciation and amortization	5,535	4,689	18.0	15,585	13,342	16.8
Total operating costs and expenses	294,807	273,079	8.0	874,991	812,079	7.7
Operating income	22,779	23,019	(1.0)	67,674	70,027	(3.4)
Interest income, net	1,173	826	42.0	4,487	2,596	72.8
Gain on sale of Mantas, Inc.				3,674		100.0
Income before taxes	23,952	23,845	0.4	75,835	72,623	4.4
Provision for income taxes	8,979	9,062	(0.9)	29,058	27,547	5.5
Net income	$ 14,973	$ 14,783	1.3%	$ 46,777	$ 45,076	3.8%

	(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	74.8	74.4	75.4	75.0
Selling, general and administrative	16.2	16.3	15.8	15.6
Depreciation and amortization	1.7	1.6	1.7	1.5
Total operating costs and expenses	92.8	92.2	92.8	92.1
Operating income	7.2	7.8	7.2	7.9
Interest income, net	0.3	0.3	0.4	0.3
Gain on sale of Mantas, Inc.			0.4	
Income before taxes	7.5	8.1	8.0	8.2
Provision for income taxes	2.8	3.1	3.1	3.1
Net income	4.7%	5.0%	5.0%	5.1%

THREE MONTHS ENDED MARCH 31, 2007 COMPARED TO THREE MONTHS ENDED

MARCH 31, 2006

Revenue

For the three months ended March 31, 2007, our revenue increased 7.3% to $317.6 million, from $296.1 million for the three months ended March 31, 2006. The primary driver of our revenue growth was our October 2006 acquisition of RABA.

Cost of Services

For the three months ended March 31, 2007, cost of services increased 7.9% to $237.7 million, from $220.3 million for the three months ended March 31, 2006. This increase in cost of services was due primarily to the volume of services attributable to RABA s existing contracts. As a percentage of revenue, cost of services increased to 74.8% in the three months ended March 31, 2007, from 74.4% in the three months ended March 31, 2006. This increase as a percentage of revenue was primarily attributable to lower margin on a re-competed contract.

Selling, General and Administrative Expenses

For the three months ended March 31, 2007, selling, general and administrative expenses increased 7.2% to $51.6 million, from $48.1 million for the three months ended March 31, 2006. As a percentage of revenue, selling, general and administrative expenses decreased to 16.2% for the three months ended March 31, 2007, from 16.3% for the three months ended March 31, 2006. This decrease as a percentage of revenue is due primarily to improved cost management and efficiencies as well as lower stock-based compensation expense resulting from adjustments to account for the forfeitures of certain share-based awards by employees. This decrease was partially offset by an increase to our allowance for doubtful accounts of $1.8 million related to a potentially uncollectible receivable.

Depreciation and Amortization

For the three months ended March 31, 2007, depreciation and amortization increased 18.0% to $5.5 million, from $4.7 million for the three months ended March 31, 2006. As a percentage of revenue, depreciation and amortization increased to 1.7% for the three months ended March 31, 2007, from 1.6% for the three months ended March 31, 2006. This increase in depreciation and amortization resulted primarily from the amortization associated with the identified intangibles recorded as a result of our acquisition of RABA.

Interest Income

For the three months ended March 31, 2007, interest income increased to $1.2 million, from $0.8 million for the three months ended March 31, 2006. This increase was due to a general rise in interest rates and higher average cash and cash equivalents and investment balances.

Income Taxes

For the three months ended March 31, 2007, our effective income tax rate decreased to 37.5%, from 38.0% for the three months ended March 31, 2006. This decrease was due primarily to higher benefits from tax credits in the three months ended March 31, 2007 than in the three months ended March 31, 2006.

NINE MONTHS ENDED MARCH 31, 2007 COMPARED TO NINE MONTHS ENDED MARCH 31, 2006

Revenue

For the nine months ended March 31, 2007, our revenue increased 6.9% to $942.7 million, from $882.1 million for the nine months ended March 31, 2006. Our Federal Deposit Insurance Corporation, or FDIC, contract was a significant driver of our revenue growth, generating approximately $19.7 million in additional revenue during the nine months ended March 31, 2007 compared to the nine months ended March 31, 2006. The remainder of our revenue growth was mostly attributable to our October 2006 acquisition of RABA.

Cost of Services

For the nine months ended March 31, 2007, cost of services increased 7.4% to $710.5 million, from $661.5 million for the nine months ended March 31, 2006. This increase in cost of services was due primarily to the increased volume of materials provided under our FDIC contract and the volume of services attributable to RABA s existing contracts. As a percentage of revenue, cost of services increased to 75.4% in the nine months ended March 31, 2007, from 75.0% in the nine months ended March 31, 2006. 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. Direct material purchases typically generate lower profit than services. Additionally, lower margin on a re-competed contract increased the ratio of cost of services to revenue.

Selling, General and Administrative Expenses

For the nine months ended March 31, 2007, selling, general and administrative expenses increased 8.5% to $148.9 million, from $137.2 million for the nine months ended March 31, 2006. As a percentage of revenue, selling, general and administrative expenses increased to 15.8% in the nine months ended March 31, 2007, from 15.6% in the nine months ended March 31, 2006. This increase is due primarily to an increase to our allowance for doubtful accounts of $1.8 million related to a potentially uncollectible receivable.

Depreciation and Amortization

For the nine months ended March 31, 2007, depreciation and amortization increased 16.8% to $15.6 million, from $13.3 million for the nine months ended March 31, 2006. As a percentage of revenue, depreciation and amortization for the nine months ended March 31, 2007 increased to 1.7% from 1.5% for the nine months ended March 31, 2006. This increase in depreciation and amortization resulted primarily from the amortization associated with the identified intangibles recorded as a result of our acquisition of RABA.

Interest Income

For the nine months ended March 31, 2007, interest income increased to $4.5 million, from $2.6 million for the nine months ended March 31, 2006. This increase was due to a general rise in interest rates and higher average cash and cash equivalents and investment balances.

Income Taxes

For the nine months ended March 31, 2007, our effective income tax rate increased to 38.3%, from 37.9% for the nine months ended March 31, 2006. This increase was due primarily to higher benefits from tax credits and refunds in the nine months ended March 31, 2006 than in the nine months ended March 31, 2007.

SEASONALITY

We generally experience a decline in operating margin during the quarter ending September 30 due to 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.

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.

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 our vendor payments. We continue to improve our invoicing and collection procedures to ensure that cash flows from operations remain a top priority.

Net cash provided by operating activities was $74.2 million for the nine months ended March 31, 2007 compared to $56.3 million for the nine months ended March 31, 2006, or 1.6 and 1.2 times net income for the same periods. The higher cash provided by operating activities was driven primarily by increased customer collections as a result of internal process initiatives implemented to improve our invoicing and collection of accounts receivable. This was partially offset by higher working capital requirements due to timing of certain tax and vendor payments in the nine months ended March 31, 2007.

We used $99.1 million in net cash for investing activities in the nine months ended March 31, 2007, compared to $91.5 million in the nine months ended March 31, 2006. The amount of cash used in the completion of our acquisitions was similar in the nine months ended March 31, 2007 and 2006. Cash used for investing activities was lower in the nine months ended March 31, 2006 due to higher sales and maturities of investments with original maturities in excess of 90 days.

Net cash provided by financing activities was $15.2 million in the nine months ended March 31, 2007, compared to $26.8 million in the nine months ended March 31, 2006. The decrease was due to lower stock option exercises and related tax benefits of stock option exercises.

Credit Facility and Borrowing Capacity

Since our May 2002 initial public offering, we have been able to meet all of our liquidity requirements, including the completion of eight acquisitions, with cash generated from our operations. We do not currently maintain a commercial credit facility as we expect our cash and cash equivalents and investments, together with cash flow generated from operations, to meet our normal operating liquidity and capital expenditure requirements. We periodically evaluate our cash requirements and, if appropriate, will establish a credit facility to finance acquisitions. 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.

OFF-BALANCE SHEET ARRANGEMENTS

We do not have any off-balance sheet arrangements.

CONTRACTUAL OBLIGATIONS

The following table summarizes our contractual obligations as of March 31, 2007 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 March 31, 2007.

	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	$ 172,240	$ 27,658	$ 47,877	$ 36,071	$ 60,634
Total contractual obligations	$ 172,240	$ 27,658	$ 47,877	$ 36,071	$ 60,634

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 where we perform systems design, development and integration is 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 outsourcing and managed services contracts is generally recognized ratably over the contract period. Revenue on fixed-price strategic consulting contracts is generally recognized based on costs incurred because these services are directed by our customers and are subject to their needs which fluctuate throughout the contract period. 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 act as an agent 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.

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. This allowance for doubtful accounts is based on several factors, including the customer s payment history, the age of the accounts receivable, and management s judgment regarding the likelihood of collection. 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 collected. Such an issue arose in the three months ended March 31, 2007 and we increased the allowance for doubtful accounts by $1.8 million.

Contract Cost Accounting

As a contractor providing services primarily to the federal government, we must 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 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, certain stock-based compensation and the amortization of identified intangible assets, among others. As we acquire and integrate new companies, we try to manage our indirect costs by realizing opportunities for cost synergies and integrating the indirect support function 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, but generally not 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. We performed our annual goodwill impairment analysis as of January 1, 2007. 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 could materially affect 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 have a process pursuant to which we typically 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. To a lesser degree, 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. 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, stock-based compensation expense, and expenses related to uncollectible accounts receivable 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 options relating to those contracts, less the amount of revenue we have previously recognized under those contracts. Backlog includes all contract options that have been priced but not yet funded. Backlog also includes the contract value under single award indefinite delivery, indefinite quantity, or ID/IQ, contracts against which we expect future task orders to be issued without competition. Backlog does not take contract ceiling value into consideration under multiple award contracts, nor does it include any estimate of future potential delivery orders that might be awarded under multiple award ID/IQ vehicles, government-wide acquisition contracts, or GWACs, or General Services Administration, or GSA, schedule 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.

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 working 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 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 nine month organic growth rates of 1.9% and 3.1%, respectively, as follows:

	Three Months Ended March 31,		
	2007	2006	% Increase
Revenue, as reported	$ 317,586	$ 296,098	7.3%
Plus: Revenue from acquired companies for the comparable prior year period		15,660	
Organic Revenue	$ 317,586	$ 311,758	1.9%

	Nine Months Ended March 31,		
	2007	2006	% Increase
Revenue, as reported	$ 942,665	$ 882,106	6.9%
Plus: Revenue from acquired companies for the comparable prior year period		32,043	
Organic Revenue	$ 942,665	$ 914,149	3.1%

Recent Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 (SFAS 157), Fair Value Measurements. SFAS 157 provides a new single authoritative definition of fair value and enhanced guidance for measuring the fair value of assets and liabilities. It requires additional disclosures related to the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS 157 is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We are currently evaluating what effect, if any, the adoption of SFAS 157 will have on our financial position, results of operations, or cash flows.

In July 2006, the FASB issued Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes, and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. We are currently evaluating what effect the adoption of FIN 48 will have on our financial position, results of operations, or cash flows.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159 (SFAS 159), The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115. SFAS No. 159 permits entities to choose to measure eligible items at fair value at specified election dates and report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating what effect, if any, the adoption of SFAS 159 will have on our financial position, results of operations, or cash flows.

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 Poor s. 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 affected 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 March 31, 2007 and June 30, 2006, the carrying value of our financial instruments approximated fair value. These investments consist of corporate and municipal debt obligations with maturities of 4 months or less that are classified as held-to-maturity.

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 defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of March 31, 2007. Based on this evaluation, our chief executive officer and chief financial officer concluded that, as of March 31, 2007, our disclosure controls and procedures were effective at the reasonable assurance level.

No change in our internal control over financial reporting occurred during the fiscal quarter ended March 31, 2007 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 1A. Risk Factors

Risks Related To Our Industry

A reduction in the U.S. defense budget or the diversion of funding from IT services and solutions to support the war against terrorism or the reconstruction of Iraq 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 48%, 49%, and 53% of our revenue for the nine months ended March 31, 2007, fiscal 2006, and fiscal 2005, respectively. A decline in overall U.S. military expenditures, or in the portion of those expenditures allocated to information technology services and solutions, 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, the reconstruction of Iraq, or natural disaster recovery could result in a substantial decrease in our revenue.

Revenue from contracts with civil agency clients accounted for 51%, 50%, and 46% of our revenue for the nine months ended March 31, 2007, fiscal 2006, and fiscal 2005, respectively. We expect civil agency clients will continue to represent a substantial portion of our future revenue. A decline in expenditures by civil agencies, or in the portion of those expenditures allocated to information technology services and solutions, 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, natural disaster recovery, 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;
- new legislation, procurement regulations, or union pressure that cause federal agencies to adopt restrictive procurement practices regarding the use of outside information technology providers;
- changes in policy and goals by the government providing set aside funds to small businesses, disadvantaged businesses, and other socio-economic requirements in the allocation of contracts; 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 is unable to pass the annual budget on a timely basis, 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 under 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 potentially cancelled.

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 the 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 ID/IQ 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.

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.

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.

Risks Related To Our Business

We depend on contracts with U.S. federal government agencies 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 48%, 49%, and 53%, of our revenue for the nine months ended March 31, 2007, fiscal 2006, and fiscal 2005, 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 senior management with client personnel. The loss of any member of our senior management could impair our ability to identify and secure new contracts and to maintain good client relations. Additionally, to the extent that our performance does not meet client expectations, or our reputation with one or more key clients is impaired, our revenue and operating results could be materially harmed.

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 possibility that difficult market conditions will cause our competitors to strive for growth by reducing their bid pricing and compel us to choose between bidding at unprofitable levels or losing contracts and foregoing revenue;
- 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.

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.

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 five GSA schedule contracts and as a prime contractor under three GWACs and more than 35 agency-specific indefinite delivery/indefinite quantity, or ID/IQ, contracts. For the nine months ended March 31, 2007, fiscal 2006, and fiscal 2005, revenue from GSA schedule contracts, GWACs, and other ID/IQ contracts accounted for approximately 76%, 76%, and 77%, respectively, of our revenue from 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 GSA intends to combine two of its large GWACs, Millennia and ANSWER, and other specialized contracts under a new Alliant contract to be competitively awarded. We expect the GSA to award the new Alliant contract in 2007. 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 has 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 the 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 ID/IQ 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.

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 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. 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 29%, 30%, and 32% of our revenue for the nine months ended March 31, 2007, fiscal 2006, and fiscal 2005, respectively.

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 29%, 30%, and 32% of our revenue for the nine months ended March 31, 2007, fiscal 2006, and fiscal 2005, 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.

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;

timing of significant bid and proposal costs;

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 or their priorities that affect the timing of technology procurement;

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

interruption by events beyond our control such as earthquakes, power losses, telecommunications failures, hurricanes, and incidents of terrorism; 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, when they are terminated, or when they 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.

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 hire significant numbers of highly qualified individuals who have advanced information technology and technical services skills and who work well with our clients in a government environment. In some cases, they are required to have security clearances issued by the Department of Defense or other government agencies. 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.

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 or contract funding modification.

We provide professional services and sometimes procure 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 or provide services in advance of receiving formal contractual authorization from the government client or a prime contractor. If our government or prime contractor requirements should change or the government directs the anticipated procurement to a contractor other than us, or if the materials become obsolete or require modification before we are under contract for the procurement, our investment might be at risk. If we do not receive the required funding, our cost of services incurred in excess of contractual funding may not be recoverable. This could reduce anticipated revenue or result in a loss, negatively affecting our cash flow and profitability.

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 nine months ended March 31, 2007, we derived 45%, 41%, and 14%

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 along with the cost of 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 due to the potential for cost overruns. 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.

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.

Under certain 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.

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, which 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.

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. Additionally, if we are unable to successfully integrate companies we acquire, our revenue and operating results may be impaired.

One of our strategies is to augment our organic growth through acquisitions. We have completed eight acquisitions of 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. Acquisitions of businesses or other material operations may require additional debt or equity financing, resulting in leverage or dilution of ownership. Additionally, 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 and we may not be able to successfully integrate the companies we acquire. We also may not realize cost efficiencies or synergies that we anticipated when selecting our acquisition candidates. Acquired companies may have liabilities or adverse operating issues that we fail to discover through due diligence. Any costs, liabilities, or disruptions associated with future acquisitions could harm our operating results. 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.

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, or DCMA and the Defense Contract Audit Agency, or DCAA. 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.

Audits for costs incurred on work performed after fiscal year 2005 have not yet been completed. In addition, non-audit reviews by the government may still be conducted on all our government contracts. 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.

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 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.

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.

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.

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 March 31, 2007 we had approximately 200 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 one year. Our standard practice in the absence of a significant call-up is to provide for up to 15 days 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.

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 April 27, 2007, Ernst Volgenau, our chairman, beneficially owned 107,618 shares of class A common stock and 12,050,736 shares of class B common stock, which represented approximately 65.2% of the combined voting power of our outstanding common stock. As of April 27, 2007, our executive officers and directors as a group beneficially owned an aggregate of 1,913,401 shares of class A common stock and 14,199,828 shares of class B common stock, which represented approximately 77.4% 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.

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 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

None

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

None

Item 5. Other Information

None

Item 6. Exhibits

Exhibit Number	Description
10.1	Employment Agreement dated April 18, 2007 between SRA International, Inc. and Stanton D. Sloane
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

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 3rd day of May, 2007.

SRA INTERNATIONAL, INC.

By: /s/ STANTON D. SLOANE
Stanton D. Sloane
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)