

SI INTERNATIONAL INC
Form 10-Q
November 05, 2008
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTER ENDED SEPTEMBER 27, 2008**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number **000-50080**

SI International, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

12012 Sunset Hills Road

Reston, Virginia
(Address of principal executive offices)

52-2127278
(I.R.S. Employer
Identification No.)

20190-5869
(Zip Code)

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

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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. Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

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

As of November 3, 2008, we had 13,295,869 shares outstanding of the registrant's common stock.

Table of Contents

SI INTERNATIONAL, INC.

FORM 10-Q

INDEX

| | Page |
|--|-------------|
| <u>PART I.</u> | |
| <u>FINANCIAL INFORMATION</u> | |
| <u>ITEM 1</u> | |
| <u>Financial Statements</u> | 3 |
| <u>Consolidated Balance Sheets (unaudited) at September 27, 2008 and December 29, 2007</u> | 3 |
| <u>Consolidated Statements of Operations (unaudited) for the three and nine months ended September 27, 2008 and September 29, 2007</u> | 4 |
| <u>Consolidated Statements of Cash Flows (unaudited) for the nine months ended September 27, 2008 and September 29, 2007</u> | 5 |
| <u>Consolidated Statements of Comprehensive Income (unaudited) for the three and nine months ended September 27, 2008 and for September 29, 2007</u> | 6 |
| <u>Notes to Consolidated Financial Statements</u> | 7 |
| <u>ITEM 2</u> | |
| <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 17 |
| <u>ITEM 3</u> | |
| <u>Quantitative and Qualitative Disclosures about Market Risk</u> | 23 |
| <u>ITEM 4</u> | |
| <u>Controls and Procedures</u> | 24 |
| <u>PART II.</u> | |
| <u>OTHER INFORMATION</u> | |
| <u>ITEM 1</u> | |
| <u>Legal Proceedings</u> | 25 |
| <u>ITEM 1A.</u> | |
| <u>Risk Factors</u> | 25 |
| <u>ITEM 2</u> | |
| <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 25 |
| <u>ITEM 3</u> | |
| <u>Defaults upon Senior Securities</u> | 26 |
| <u>ITEM 4</u> | |
| <u>Submission of Matters to a Vote of Security Holders</u> | 26 |
| <u>ITEM 5</u> | |
| <u>Other Information</u> | 26 |
| <u>ITEM 6</u> | |
| <u>Exhibits</u> | 26 |
| <u>Signatures</u> | 27 |
| <u>Index to Exhibits</u> | 28 |

Table of Contents

PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

SI International, Inc. and Subsidiaries

Consolidated Balance Sheets

(Amounts in thousands, except share data)

Unaudited

| | September 27, 2008 | December 29, 2007 |
|--|-----------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 1,212 | \$ 13,129 |
| Accounts receivable, net | 129,845 | 117,098 |
| Other current assets | 14,099 | 12,511 |
| Total current assets | 145,156 | 142,738 |
| Property and equipment, net | 14,065 | 15,080 |
| Intangible assets, net | 23,317 | 26,583 |
| Other assets | 10,908 | 11,572 |
| Goodwill | 265,474 | 265,474 |
| Total assets | \$ 458,920 | \$ 461,447 |
| Liabilities and stockholders' equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 20,783 | \$ 26,000 |
| Accrued expenses and other current liabilities | 49,767 | 35,172 |
| Note payable - line of credit | | 20,000 |
| Current portion of long-term debt | | 1,004 |
| Total current liabilities | 70,550 | 82,176 |
| Long-term debt, net of current portion | 101,750 | 93,261 |
| Deferred income tax, net | 15,754 | 14,241 |
| Other long-term liabilities | 9,796 | 11,066 |
| Stockholders' equity: | | |
| Common stock \$0.01 par value per share; 50,000,000 shares authorized; 13,132,329 and 13,087,164 shares issued and outstanding as of September 27, 2008 and December 29, 2007, respectively | 131 | 131 |
| Additional paid-in capital | 190,480 | 188,308 |
| Accumulated other comprehensive loss | (1,279) | (1,094) |
| Treasury stock - 557,409 shares as of September 27, 2008, at cost | (11,942) | |
| Retained earnings | 83,680 | 73,358 |
| Total stockholders' equity | 261,071 | 260,703 |
| Total liabilities and stockholders' equity | \$ 458,920 | \$ 461,447 |

See accompanying notes

Table of Contents**SI International, Inc. and Subsidiaries****Consolidated Statements of Operations****(Amounts in thousands, except per share data)****Unaudited**

| | Three Months Ended | | Nine Months Ended | |
|---|---------------------------|----------------------|--------------------------|----------------------|
| | Sept 27, 2008 | Sept 29, 2007 | Sept 27, 2008 | Sept 29, 2007 |
| Revenue | \$ 148,952 | \$ 141,109 | \$ 426,141 | \$ 373,602 |
| Operating costs and expenses: | | | | |
| Cost of services | 100,285 | 92,915 | 283,023 | 237,541 |
| Selling, general and administrative | 39,765 | 36,478 | 114,338 | 102,195 |
| Depreciation and amortization | 1,046 | 935 | 3,181 | 2,548 |
| Amortization of intangible assets | 1,076 | 1,370 | 3,266 | 2,887 |
| Total operating costs and expenses | 142,172 | 131,698 | 403,808 | 345,171 |
| Income from operations | 6,780 | 9,411 | 22,333 | 28,431 |
| Interest expense, net | (1,627) | (2,201) | (4,985) | (5,170) |
| Income before provision for income taxes | 5,153 | 7,210 | 17,348 | 23,261 |
| Provision for income taxes | 2,087 | 2,827 | 7,026 | 9,121 |
| Net income | \$ 3,066 | \$ 4,383 | \$ 10,322 | \$ 14,140 |
| Earnings per common share: | | | | |
| Basic | \$ 0.24 | \$ 0.34 | \$ 0.79 | \$ 1.09 |
| Diluted | \$ 0.23 | \$ 0.33 | \$ 0.78 | \$ 1.06 |
| Basic weighted-average shares outstanding | 12,724 | 13,050 | 12,971 | 13,012 |
| Diluted weighted-average shares outstanding | 12,968 | 13,339 | 13,198 | 13,294 |

See accompanying notes

Table of Contents

SI International, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(Amounts in thousands)

Unaudited

| | Nine Months Ended | |
|---|-----------------------|-----------------------|
| | September 27, 2008 | September 29, 2007 |
| Cash flows from operating activities: | | |
| Net income | \$ 10,322 | \$ 14,140 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 3,181 | 2,548 |
| Amortization of intangible assets | 3,266 | 2,887 |
| Stock-based compensation | 1,364 | 39 |
| Loss on disposal of fixed assets | | 843 |
| Amortization of deferred financing costs | 383 | 626 |
| Changes in operating assets and liabilities, net of effect of acquisitions: | | |
| Accounts receivable, net | (12,747) | (6,376) |
| Other current assets | 53 | (254) |
| Other assets | 1,175 | (4,770) |
| Accounts payable and accrued expenses | 9,152 | (61) |
| Other long-term liabilities | (1,230) | 3,031 |
| Net cash provided by operating activities | 14,919 | 12,653 |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (2,166) | (4,678) |
| Proceeds from sale of marketable securities | | 43,250 |
| Purchase of marketable securities | | (43,250) |
| Former owner payable | | (6,000) |
| Cash paid for business acquisitions, net of cash assumed | | (60,371) |
| Net cash used in investing activities | (2,166) | (71,049) |
| Cash flows from financing activities: | | |
| Borrowings under line of credit | 56,750 | 20,000 |
| Repayments under line of credit | (35,000) | |
| Proceeds from exercise of stock options | 669 | 1,373 |
| Income tax benefit for stock option exercises | 140 | 244 |
| Proceeds from long-term debt | 60,000 | 25,000 |
| Repayments of long-term debt | (94,265) | (690) |
| Repurchase of common stock | (11,942) | |
| Payments of debt issuance costs | (935) | (108) |
| Repayments of capital lease obligations | (87) | (82) |
| Net cash (used in) provided by financing activities | (24,670) | 45,737 |
| Net change in cash and cash equivalents | (11,917) | (12,659) |
| Cash and cash equivalents, beginning of period | 13,129 | 19,457 |
| Cash and cash equivalents, end of period | \$ 1,212 | \$ 6,798 |
| Supplemental disclosures of cash flow information: | | |
| Cash payments for interest | \$ 4,522 | \$ 5,687 |
| Cash payments for income taxes | \$ 5,375 | \$ 7,924 |

See accompanying notes

Table of Contents

SI International, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income

(Amounts in thousands)

Unaudited

| | Three Months Ended | | Nine Months Ended | |
|---------------------------------------|--------------------|---------------|-------------------|---------------|
| | Sept 27, 2008 | Sept 29, 2007 | Sept 27, 2008 | Sept 29, 2007 |
| Net income | \$ 3,066 | \$ 4,383 | \$ 10,322 | \$ 14,140 |
| Unrealized loss on interest rate swap | (9) | (438) | (185) | (610) |
| Comprehensive income | \$ 3,057 | \$ 3,945 | \$ 10,137 | \$ 13,530 |

See accompanying notes

Table of Contents

SI International, Inc. and Subsidiaries

Notes to consolidated financial statements

(Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements of SI International, Inc. and its subsidiaries have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the quarter ended September 27, 2008 are not necessarily indicative of the results that may be expected for the year ending December 27, 2008. For further information, refer to the financial statements and footnotes included in SI International's Annual Report on Form 10-K for the year ended December 29, 2007. References to the Company, we, us, and our refer to SI International, Inc. and its subsidiaries.

2. Summary of significant accounting policies:

Principles of consolidation

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

Use of estimates

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

Reporting periods

The Company's fiscal year is based on the calendar year and ends each year on the Saturday nearest, but not falling after, December 31 of that year. As a result, our fiscal year may be comprised of 52 or 53 weeks. Typically, fiscal quarters also end on the Saturday nearest, but not falling after, the end of the calendar quarter. However, we will end those fiscal quarters presented in our Forms 10-Q (the first three fiscal quarters) on the Saturday which provides us with a 13-week quarter even if that Saturday falls after the end of the calendar quarter. As a result, in the future, if our fiscal year comprises 53 weeks, the first three quarters shall each be comprised of 13 weeks and the fourth quarter shall be comprised of 14 weeks. Consistent with this policy, our third quarters ended September 27, 2008 and September 29, 2007 were 13-week quarters.

Cash and cash equivalents

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

Marketable securities

As of September 27, 2008 and December 29, 2007, the Company held no investments in marketable securities.

Revenue Recognition

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

Table of Contents

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

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

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

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

Contract revenue recognition inherently involves estimation, including the contemplated level of effort to accomplish the tasks under contract, the cost of the effort, and an ongoing assessment of progress toward completing the contract. From time to time, as part of the normal management processes, facts develop that require revisions to estimated total costs or revenues expected. The cumulative impact of any revisions to estimates and the full impact of anticipated losses on contracts accounted for under SOP 81-1 are recognized in the period in which they become known. Losses on all other contracts are recognized as the services and materials are provided.

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

Significant customers

Revenue generated from contracts with the Federal Government, both directly and through other prime contractors, accounted for a significant percent of revenues in the fiscal periods ending September 27, 2008 and September 29, 2007, as follows:

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| | Three Months Ended | | Nine Months Ended | |
|---------------------------|--------------------|---------------|-------------------|---------------|
| | Sept 27, 2008 | Sept 29, 2007 | Sept 27, 2008 | Sept 29, 2007 |
| Department of Defense | 44.6% | 47.4% | 43.1% | 45.9% |
| Federal civilian agencies | 54.7 | 51.7 | 56.1 | 53.0 |
| Commercial entities | 0.7 | 0.9 | 0.8 | 1.1 |
| Total revenue | 100.0% | 100.0% | 100.0% | 100.0% |

For the three months ended September 27, 2008 and September 29, 2007, we had one contract vehicle that generated more than 10% of our revenue. That contract is our Command, Control, Communications, Computer, Intelligence, Information, Technology, Surveillance, and Reconnaissance contract vehicle, or C4I2TSR, which is an Indefinite Delivery-Indefinite Quantity, or ID/IQ, contract vehicle administered and primarily used by the U.S. Air Force Space Command, however, it is also available for use by different Federal Government agencies. As there are projects issued under C4I2TSR for different customers, we assign and report revenue generated from any task order to the appropriate Company business unit. Under this approach, for the three and nine months ended September 27, 2008, our C4I2TSR contract vehicle represented approximately 13.3% and 12.5% of our revenue, respectively. For the three and nine months ended September 29, 2007, our C4I2TSR contract vehicle represented approximately 14.4% and 16.8% of our revenue, respectively.

Table of Contents**Deferred financing costs**

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

| | September 27, 2008 | December 29, 2007 |
|-------------------------------|-----------------------|----------------------|
| Deferred loan costs | \$ 6,530 | \$ 5,635 |
| Accumulated amortization | (4,370) | (3,987) |
| Deferred financing costs, net | \$ 2,160 | \$ 1,648 |

The increase in deferred loan costs of approximately \$0.9 million in 2008 was due to the Company's execution of its Second Amended and Restated Credit Agreement on February 13, 2008, as more fully described in Note 7.

Fair value of financial instruments

The Company's financial instruments consist primarily of cash and cash equivalents, marketable securities, accounts receivable, accounts payable, credit facilities, and long-term debt. In management's opinion, the carrying amounts of these financial instruments approximate their fair values at September 27, 2008 and December 29, 2007.

Stock-based compensation

Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123R, *Share Based Payment*, using the modified prospective transition method. Due to the use of the modified prospective method, prior interim periods and fiscal years do not reflect any restated amounts. The Company accelerated the vesting of unvested stock options previously awarded to employees, officers and directors in December 2005; thus the Company had no unvested stock options on January 1, 2006. Since January 1, 2006, the Company has issued 507,200 stock options through September 27, 2008. The total stock compensation expense recognized for stock options during the quarters ended September 27, 2008 and September 29, 2007 was \$0.3 million and \$0.2 million, respectively. The total remaining unrecognized compensation expense related to the unvested options as of September 27, 2008 was \$3.6 million.

From January 1, 2006 through September 27, 2008, the Company has issued 182,125 shares of restricted stock to directors and employees under its 2002 Amended and Restated Omnibus Stock Incentive Plan. The fair value of the restricted stock awards is determined based on the grant date stock price. The compensation expense for restricted stock awards is recognized beginning on the date of grant on either a straight-line basis over the vesting term, which is typically five years, or over the expected period of performance for awards with performance-based vesting. The total compensation expense recognized during fiscal quarters ended September 27, 2008 and September 29, 2007 was \$0.2 million and \$0.1 million, respectively. The total remaining unrecognized compensation expense related to the unvested restricted stock awards as of

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September 27, 2008 was \$3.1 million.

In connection with the Merger, as defined in Note 10 to the financial statements, the outstanding options with a stock price below the purchase price per share and all outstanding restricted shares will receive the Merger Consideration upon the change-in-control.

The fair value of each option is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions used for grants during the fiscal periods ended September 27, 2008 and September 29, 2007:

| | Fiscal Period | |
|---------------------------------|---------------|---------------|
| | Sept 27, 2008 | Sept 29, 2007 |
| Risk-free interest rate | 2.80 - 2.89% | 4.67 - 5.03% |
| Expected life of options | 5 years | 5 years |
| Expected stock price volatility | 41.7% | 34.5% |
| Expected dividend yield | 0% | 0% |

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

Table of Contents

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

Earnings per share

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

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

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|------------------|-------------------|------------------|
| | Sept 27, 2008 | Sept 29, 2007 | Sept 27, 2008 | Sept 29, 2007 |
| Net Income Basic and Diluted | \$ 3,066 | \$ 4,383 | \$ 10,322 | \$ 14,140 |
| Weighted average share calculation: | | | | |
| Basic weighted-average shares outstanding | 12,724 | 13,050 | 12,971 | 13,012 |
| Treasury stock effect of stock options | 244 | 289 | 227 | 282 |
| Diluted weighted-average shares outstanding | 12,968 | 13,339 | 13,198 | 13,294 |

Income Taxes

Income taxes are accounted for using an asset and liability approach that requires the recognition of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in the Company's financial statements or tax returns. The measurement of current and deferred tax liabilities and assets are based on provisions of the enacted tax law; the effects of future changes in tax laws or rates are not considered. Net deferred tax assets are reduced, if necessary, by a valuation allowance for the amount of any tax benefits that, based on available evidence, are not expected to be realized.

Derivative Instrument and Hedging Activities

The Company accounts for derivative instruments and hedging activities in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended. Derivatives are recognized as either assets or liabilities in the consolidated balance sheets, and gains and losses are recognized based on changes in the fair values. Gains and losses on derivatives designated as a hedge, or deemed to be an

effective hedge, are deferred in accumulated other comprehensive loss in the accompanying consolidated balance sheets. Gains and losses on derivatives that are not designated as a hedge, or that are not intended to be an effective hedge, are recognized upon the changes in fair values and are recorded in the accompanying consolidated statements of operations. The classification of gains and losses resulting from the changes in fair values is dependent on the intended use of the derivative and its resulting designation. The Company uses the change in variable cash flow method to measure the effectiveness of its hedges.

From time to time, the Company will enter into interest rate swap agreements to manage exposure to fluctuations in rates on its variable rate debt. These agreements effectively allow the Company to exchange variable rate debt for fixed rate debt. The Company enters into such derivative instrument agreements only to hedge cash flows. The Company does not hold or issue such financial instruments for trading purposes, nor is it a party to leveraged derivatives.

Nonqualified Deferred Compensation Plan

The Company maintains a non-qualified defined contribution supplemental retirement savings plan for certain key employees whereby participants may elect to defer and contribute a portion of their compensation, as permitted by the plan. The Company maintains supplemental retirement savings plan assets that are accounted for in accordance with Emerging Issues Task Force (EITF) Issue No. 97-14, *Accounting for Deferred Compensation Arrangements Where Accounts are Held in a Rabbi Trust and Invested*, and the underlying assets are held in a rabbi trust. The participants can direct their investments in the nonqualified deferred compensation plan.

Table of Contents

A rabbi trust is a grantor trust established to fund compensation for a select group of management. The assets of this trust are available to satisfy the claims of general creditors in the event of bankruptcy of the Company. The assets held by the rabbi trust, which are classified as trading securities, are recorded at fair value in the consolidated financial statements as nonqualified deferred compensation plan assets. The participants investments are recorded at fair value as nonqualified deferred compensation plan obligations.

Segment reporting

SFAS No. 131, *Disclosure about Segments of an Enterprise and Related Information*, establishes standards for the way that public business enterprises report information about operating segments in annual financial statements and requires that these enterprises report selected information about operating segments in interim financial reports. SFAS No. 131 also establishes standards for related disclosures about products and services, geographic areas and major customers. Management has concluded that the Company operates in one segment based upon the information used by management in evaluating the performance of its business and allocating resources and capital.

Reclassifications

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

New accounting pronouncements

In March 2008, the Financial Accounting Standards Board (FASB) issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities – an Amendment of FASB Statement No. 133* (SFAS No. 161), which requires expanded disclosures about derivative and hedging activities. This statement changes the disclosure requirements for derivative instruments and hedging activities by requiring companies to provide enhanced disclosures about how and why they use derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and how derivative instruments and related hedged items affect a company's financial position, financial performance and cash flows. SFAS No. 161 is effective for fiscal periods beginning after November 15, 2008. The Company will adopt the requirements of SFAS No. 161 at the beginning of fiscal year 2009 and has not yet evaluated the impact, if any, that SFAS No. 161 will have on its disclosures.

In the first quarter of 2008, we adopted SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a market-based hierarchy for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 is applicable whenever another accounting pronouncement requires or permits assets and liabilities to be measured at fair value, but does not require any new fair value measurements. The SFAS No. 157 requirements for certain non-financial assets and liabilities have been deferred until the first quarter of 2009 in accordance with Financial Accounting Standards Board Staff Position (FSP) 157-2. The adoption of SFAS No. 157 did not have a material impact on our results of operations, financial position or cash flows.

The fair-value hierarchy established in SFAS No. 157 prioritizes the inputs used in valuation techniques into three levels as follows:

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- Level 1 Observable inputs quoted prices in active markets for identical assets and liabilities;
- Level 2 Observable inputs other than the quoted prices in active markets for identical assets and liabilities includes quoted prices for similar instruments, quoted prices for identical or similar instruments in inactive markets, and amounts derived from valuation models where all significant inputs are observable in active markets; and
- Level 3 Unobservable inputs includes amounts derived from valuation models where one or more significant inputs are unobservable and require us to develop relevant assumptions.

The amount of financial assets and liabilities we recorded at fair value at September 27, 2008 totaled \$4.1 million and \$6.8 million, respectively, as follows:

| Description | Type | Valuation Methodology | Fair Value (\$000 s) |
|--|----------------------|------------------------------|-----------------------------|
| Assets held in a rabbi trust | Long-term asset | Level 1 | \$ 4,107 |
| Non-qualified deferred compensation plan liabilities | Long-term liability | Level 1 | \$ 4,752 |
| Interest rate swap | Short-term liability | Level 2 | \$ 2,073 |

Table of Contents

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* (SFAS No. 159). SFAS No. 159 permits entities to choose to measure certain financial instruments and other items at fair value. The fair value option generally may be applied instrument by instrument, is irrevocable, and is applied only to entire instruments and not to portions of instruments. SFAS No. 159 became effective for financial statements issued for fiscal years beginning after November 15, 2007. The adoption of this statement did not have a material impact on its financial condition, results of operations or cash flows, as we did not elect to measure any items at fair value under SFAS No. 159.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (SFAS No. 141R). SFAS No. 141R establishes principles and requirements for how companies recognize and measure identifiable assets acquired, liabilities assumed, and any non-controlling interest in connection with a business combination; recognize and measure the goodwill acquired in a business combination; and determine what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141R is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company has not yet evaluated what impact, if any, SFAS No. 141R will have on its results of operations or financial position.

3. Accounts receivable:

Accounts receivable consists of the following (in thousands):

| | September 27, 2008 | December 29, 2007 |
|---|-----------------------|----------------------|
| Billed accounts receivable | \$ 58,273 | \$ 52,814 |
| Unbilled accounts receivable: | | |
| Currently billable | 65,298 | 58,700 |
| Unbilled retainages and milestone payments expected to be billed within the next 12 months | 5,435 | 5,837 |
| Indirect costs incurred and charged to cost-plus contracts in excess of provisional billing rates | 2,122 | 1,030 |
| Total unbilled accounts receivable | 72,855 | 65,567 |
| Allowance for doubtful accounts | (1,283) | (1,283) |
| Accounts receivable, net | \$ 129,845 | \$ 117,098 |

The currently billable amounts included as unbilled accounts receivable as of September 27, 2008 and December 29, 2007 represent amounts which are billed during the following quarter of the current year. They are billings for services rendered prior to quarter-end, which are billed once necessary billing data has been collected and an invoice is produced.

4. Property and equipment:

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

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| | September 27, 2008 | December 29, 2007 |
|--|-----------------------|----------------------|
| Computers and equipment | \$ 12,944 | \$ 12,338 |
| Software | 4,642 | 4,628 |
| Furniture and fixtures | 6,979 | 6,382 |
| Leasehold improvements | 7,965 | 7,016 |
| Total property and equipment | 32,530 | 30,364 |
| Less Accumulated depreciation and amortization | (18,465) | (15,284) |
| Property and equipment, net | \$ 14,065 | \$ 15,080 |

Property and equipment includes assets financed under capital lease obligations of approximately \$149,000 and \$221,000, net of accumulated amortization, as of September 27, 2008 and December 29, 2007, respectively.

Table of Contents**5. Intangible assets:**

Intangible assets consist of the following (in thousands):

| | September 27, 2008 | December 29, 2007 |
|------------------------------------|-----------------------|----------------------|
| Contractual customer relationships | \$ 36,547 | \$ 36,547 |
| Non-compete agreements | 150 | 150 |
| Total intangible assets | 36,697 | 36,697 |
| Less: Accumulated amortization | (13,380) | (10,114) |
| Intangible assets, net | \$ 23,317 | \$ 26,583 |

Intangible assets from acquisitions, which consist primarily of contractual customer relationships, are amortized utilizing an accelerated method over 6 to 14 years, based on their estimated useful lives. The weighted-average amortization period of total intangible assets as of September 27, 2008, is 8.5 years. Amortization expense is estimated to be \$4.3 million, \$3.8 million, \$3.4 million, \$2.9 million, and \$2.7 million for the years 2008, 2009, 2010, 2011 and 2012, respectively.

6. Accrued expenses and other current liabilities:

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

| | September 27, 2008 | December 29, 2007 |
|--|-----------------------|----------------------|
| Accrued vacation | \$ 9,064 | \$ 7,740 |
| Accrued compensation | 10,578 | 11,412 |
| Accrued insurance | 2,918 | 1,944 |
| Accrued subcontractor costs | 14,212 | 5,947 |
| Fair value of interest rate swap | 2,073 | 1,799 |
| Deferred revenue | 2,322 | 2,338 |
| Other accrued liabilities | 8,600 | 3,992 |
| Accrued expenses and other current liabilities | \$ 49,767 | \$ 35,172 |

7. Debt:

Since 2002, the Company has maintained a credit facility with Wachovia Bank, National Association, acting as Administration Agent for a consortium of lenders. The credit facility has been amended from time to time since 2002. The credit facility is secured by a pledge of substantially all of our current and future tangible and intangible assets, as well as those of our current and future subsidiaries, including accounts receivable, inventory and capital stock.

On February 9, 2005, we entered into an Amended and Restated Credit Agreement, which was subsequently amended by a First Amendment to the Amended and Restated Credit Agreement dated February 27, 2006 and a Second Amendment to the Amended and Restated Credit Agreement (Second Amendment), dated June 8, 2007. The Second Amendment, executed contemporaneously with our closing of the LOGTEC acquisition, increased the amount of outstanding term debt by \$25 million, to a total of approximately \$95 million. Additionally, we borrowed approximately \$25 million under the revolving credit facility. As of December 29, 2007, we had approximately \$94.3 million of term debt and \$20.0 million of revolving credit debt outstanding under our credit facility.

On February 13, 2008, we entered into a Second Amended and Restated Credit Agreement (Second Amended Credit Agreement). The amended and restated credit facility consists of a revolving line of credit of up to \$140.0 million and a term loan of \$60.0 million. As of September 27, 2008, we had \$60.0 million in term debt and approximately \$41.8 million of revolving credit debt outstanding. The Second Amended Credit Agreement also amended debt covenant thresholds and lowered the variable rate margins that are to be applied to LIBOR or an alternative base rate in determining the periodic interest rate. In connection with the Second Amended Credit Agreement, the Company incurred commitment fees of approximately \$0.9 million.

At the time the Company borrows funds from either of the loan facilities under the Second Amended Credit Agreement, it may choose from two interest rate options. The Company may elect to have the borrowings bear interest at floating rates equal to LIBOR plus a spread ranging from 87.5 to 150 basis points or an alternative base rate plus a spread ranging from zero to 50 basis points.

Table of Contents

Under either the LIBOR or an alternative base rate option, the exact interest rate spread will be determined based upon the Company's leverage ratio as defined in the Second Amended Credit Agreement. Currently, the requirements of the Company's swap agreement necessitate that the Company elect the LIBOR option for its term debt. The Company pays a fee, which is based on its leverage ratio, on the unused portion of its loan facilities.

The term loan facility requires final payment in full on the term loan maturity date of February 13, 2013. The outstanding balance under the revolving line of credit facility will accrue interest at a variable rate, with interest only payments being required until the facility matures on February 13, 2013. We may repay either or both of the term loan facility and the revolving loan facility in whole or in part at anytime prior to their respective maturity dates without penalty.

Debt consists of the following (in thousands):

| | December 29, 2007 |
|---|-------------------------------|
| Credit facilities*: | |
| Line of credit bears interest at LIBOR plus 200 to 275 basis points or a specified base rate plus 100 to 175 basis points (exact rate based upon the Company's leverage ratio), interest due monthly, principal due February 9, 2010 | \$ 20,000 |
| Term loan, pursuant to the Second Amendment, as of December 29, 2007 bears interest at LIBOR plus 200 basis points or a specified base rate plus 100 basis points, with twelve consecutive quarterly principal and interest payments of \$250,904 starting on December 29, 2007, with the unpaid principal and interest of approximately \$91.3 million due on February 9, 2011 | 94,265 |
| Total debt | \$ 114,265 |
| | September 27, 2008 |
| Credit facilities*: | |
| Line of credit bears interest at LIBOR plus 87.5 to 150 basis points or a specified base rate plus 0 to 50 basis points (exact rate based upon the Company's leverage ratio), interest due monthly, principal due February 13, 2013 | \$ 41,750 |
| Term loan bears interest at LIBOR plus 87.5 to 150 basis points or a specified base rate plus 0 to 50 basis points (exact rate based upon the Company's leverage ratio), interest due monthly, principal due February 13, 2013 | 60,000 |
| Total debt | \$ 101,750 |

*As further discussed above, the total debt outstanding as of December 29, 2007 was pursuant to the Amended and Restated Credit Agreement, whereas the total debt outstanding as of September 27, 2008 was pursuant to the Second Amended Credit Agreement.

8. Commitments and contingencies:

Leases

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As of September 27, 2008, the Company has noncancelable operating leases, primarily for real estate, that expire over the next ten years. Rental expense during the quarter ended September 27, 2008 was approximately \$2.8 million, compared to rental expense of approximately \$2.5 million during the quarter ended September 29, 2007.

Contract cost audits

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

Table of Contents

Litigation and claims

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

The Shenandoah Electronic Intelligence, Inc. (SEI) acquisition agreement provides for a purchase price adjustment based upon the working capital of SEI as of the closing date. Subsequent to the closing date, we received a payment of \$1.6 million in connection with services performed prior to the closing date that SEI had not previously billed, and was not authorized to bill, its customer as of the closing date. The SEI selling stockholders have asserted that they are entitled to a credit in connection with the calculation of working capital adjustment in an amount equal to the amount received by us for this post-closing payment. We believe that, in accordance with generally accepted accounting principles, the SEI selling stockholders should not receive the benefit of the post-closing payment. In accordance with the terms of the SEI acquisition agreement, the parties have jointly submitted the issue to an independent accounting firm for resolution. We anticipate that this matter will be resolved before the end of fiscal year 2008.

From July 2001 through December 2007, the Company, through an acquired subsidiary, served as a subcontractor under a prime contract with the U.S. Department of Homeland Security and for the operation of the department's immigration service centers, including in Vermont (the SCOT Contract). In November 2007, the U.S. Department of Labor (DOL) initiated a compliance review with respect to the Service Contract Act (SCA) for the SCOT contract at the Vermont facility. The term of the SCOT Contract expired in November 2007. The period covered by the audit is from December 2005 through November 2007. We have held discussions with DOL concerning its preliminary findings; however, we are unable to determine an ultimate outcome of this matter at this time. The Company continues to cooperate with the DOL and to provide it with additional information. The Company believes that it has complied with the SCA requirements on the SCOT contract, and that the resolution of this matter will not have a material adverse effect to the Company.

9. Stockholders equity:

Stock incentive plans

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

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requirements, or materially increase benefits accruing to the participants under the Plan will be subject to stockholder approval; and (ix) making other technical changes to the Plan.

A summary of option activity under the plan as of September 27, 2008 is presented below:

| | Options | Options exercisable | Weighted-average exercise price |
|---|-----------|------------------------|------------------------------------|
| Outstanding at December 29, 2007 | 1,491,161 | 1,233,331 | \$ 23.00 |
| 2008 grants | 207,200 | | \$ 23.60 |
| 2008 exercises | (39,287) | | \$ 16.79 |
| 2008 forfeitures | (65,476) | | \$ 27.06 |
| Outstanding at September 27, 2008 | 1,593,598 | | \$ 22.89 |
| Options exercisable at September 27, 2008 | | 1,180,888 | |

Table of Contents

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

A summary of restricted awards activity under the plan as of September 27, 2008 is presented below:

| | Shares | | Weighted-average fair value |
|---|---------|----|--------------------------------|
| Non-vested shares outstanding at December 29, 2007 | 98,872 | \$ | 28.98 |
| 2008 grants | 74,700 | \$ | 23.53 |
| 2008 vests | (9,950) | \$ | 28.50 |
| 2008 forfeitures | (5,660) | \$ | 29.03 |
| Non-vested shares outstanding at September 27, 2008 | 157,962 | \$ | 26.43 |

Stock repurchase program

During the Company's Board of Directors meeting on December 6, 2005, the Board authorized the repurchase of up to 300,000 shares of its common stock. On March 24, 2008, the Company announced that its Board of Directors authorized the expansion of the Company's stock repurchase program for the repurchase of up to an additional 700,000 shares of its common stock, which brings the total of shares of common stock authorized for repurchase to 1.0 million. The Company was authorized to expend up to an aggregate maximum dollar amount of \$25.0 million from available cash and the Company's existing credit facility. The timing and volume of any purchases were determined in accordance with a Rule 10b5-1 trading plan. Subject to Rule 10b5-1 under the Exchange Act, the Company was empowered to suspend or discontinue the stock repurchase program at any time without prior notice. The Company discontinued any repurchase of stock under the program on August 27, 2008. The Company repurchased 557,409 shares of its common stock for approximately \$11.9 million under the trading plan.

10. Mergers and Acquisitions

On August 26, 2008, the Company entered into an Agreement and Plan of Merger (the "Merger Agreement") with Serco Group plc ("Serco Group"), Serco Inc. ("Serco") and Matador Acquisition Corporation, a wholly-owned subsidiary of Serco ("Merger Sub"), providing for the merger of Merger Sub with and into the Company (the "Merger").

Following the consummation of the Merger, the Company will be the surviving corporation and will be a wholly-owned subsidiary of Serco. Under the terms of the Merger Agreement, at the effective time and as a result of the Merger, each issued and outstanding share of the Company's common stock, par value \$0.01 per share (the "Common Stock"), other than shares of Common Stock held by the Company or by the Company's stockholders who properly exercise and do not waive, withdraw or otherwise lose their right to demand appraisal pursuant to Section 262 of the General Corporation Law of the State of Delaware, as amended, will be converted into the right to receive \$32.00 in cash, without interest (the "Merger Consideration"). At the effective time of the Merger, all outstanding options to acquire Common Stock, whether or not then vested and exercisable, will be canceled in exchange for the right to receive, on the terms and conditions set forth in the Merger Agreement, a cash payment equal to (i) the amount by which the Merger Consideration exceeds the exercise price of such option (if any),

multiplied by (ii) the number of shares of Common Stock subject to that option, less any applicable withholding taxes. Also at the effective time of the Merger, each share of restricted stock shall vest in full and convert into the right to receive the Merger Consideration, less any applicable withholding taxes.

The Company has made various representations and warranties and agreed to specified covenants in the Merger Agreement, including covenants relating to the Company's conduct of its business between the date of the Merger Agreement and the closing of the Merger, restrictions on solicitation of proposals with respect to alternative transactions, governmental filings and approvals, public disclosures and other matters. The Merger Agreement contains certain termination rights of Serco Group and the Company and provides that, in connection with the termination of the Merger Agreement and under specified circumstances, the Company may be required to pay Serco Group a termination fee of \$10 million and may also be required to reimburse Serco Group and Serco for transaction expenses of up to \$5 million in the aggregate. The completion of the Merger is subject to a number of conditions, including stockholder approval, the receipt of certain regulatory approvals, no material adverse effect on the Company having occurred and other customary conditions. The completion of the Merger is also subject to there existing no law or government order prohibiting the Merger. Consummation of the Merger is not conditioned upon the receipt by Serco Group or Serco of financing. As of September 27, 2008, the Company has recorded approximately \$1.5 million of pre-tax costs related to the pending merger, for use of outside consultants. The impact of those costs resulted in a \$0.08 reduction of fully diluted earnings per share for the current quarter. Upon consummation of the Merger, the Company would be required to pay a broker's fee of approximately \$3 million. This contingent fee has not yet been accrued as of September 27, 2008.

Table of Contents

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

The following discussion and analysis should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this Form 10-Q. This discussion and analysis contains forward-looking statements that involve known and unknown risks, uncertainties, and other factors that may cause our actual results, level of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. In some cases, you can identify these statements by forward-looking words such as anticipate, believe, could, estimate, expect, intend, may, plan, potential, should, will, and would or similar words. You should read statements that contain these words carefully because they discuss our future expectations, contain projections of our future results of operations or of our financial position, or state other forward-looking information. We believe that it is important to communicate our future expectations to our investors. However, there may be events in the future that we are not able to predict accurately or control. In particular, statements that we make in this section relating to the sufficiency of anticipated sources of capital to meet our cash requirements are forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including as a result of some of the factors described below, elsewhere in this Form 10-Q and in the section entitled Risk Factors in our Form 10-K for the fiscal year ended December 29, 2007. You should not place undue reliance on these forward-looking statements, which apply only as of the date of the filing of this Form 10-Q.

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

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

Overview

We are, first and foremost, a provider of information technology and network solutions (IT) to the Federal Government. Our clients include the U.S. Air Force, U.S. Army, U.S. Navy, Department of State, Department of Homeland Security, Department of Energy, Department of Commerce, Federal Retirement Thrift Investment Board, Office of Personnel Management, and the Intelligence community. We combine our technology and industry expertise to provide a full spectrum of state-of-the-practice solutions and services, from design and development to implementation and operations, which assist our clients in achieving mission success. We believe that our company is distinguishable from our peers within the federal IT sector in several important respects.

We employ a Rapid Response•Rapid Deployment® methodology that enables the rapid standing up of innovative solutions and the incorporation of additional capabilities in rapid succession. This capability allows us to respond to urgent IT imperatives quickly, often in a matter of months, and within a well defined budget. We can, therefore, provide solutions for current IT needs, while establishing a platform for advancing long-term transformational objectives. We possess a proven ability to respond to high priority information technology and network needs through innovation, and an enviable reputation for timely delivery of robust solutions on assignments where failure is not an option. Our solutions enable clients to respond to new mandates, expand the scope of their missions, and reengineer underlying business processes. We have a demonstrated ability of turning troubled IT projects into winning outcomes and realized exceptional growth from high-quality client engagements. We also utilize mature and proven processes to manage and market large-scale ID/IQ contracts, such as C4I2TSR. We employ a diverse, innovative team that effectively utilizes small business partners' unique skills and expertise for mission critical IT projects.

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For the fiscal quarters ended September 27, 2008 and September 29, 2007, we received 99.3% and 99.1%, respectively, of our revenues from services we provided to various departments and agencies of the Federal Government, both directly and through other prime contractors, and 0.7% and 0.9%, respectively, of our total revenues from work performed for commercial entities. The following table shows our revenues from the client groups listed as a percentage of total revenue. Revenue data for the Department of Defense (DoD) includes revenue generated from work performed under engagements for both the DoD and the Intelligence community.

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Table of Contents

| | Three Months Ended | | Nine Months Ended | |
|---------------------------|--------------------|---------------|-------------------|---------------|
| | Sept 27, 2008 | Sept 29, 2007 | Sept 27, 2008 | Sept 29, 2007 |
| Department of Defense | 44.6% | 47.4% | 43.1% | 45.9% |
| Federal civilian agencies | 54.7 | 51.7 | 56.1 | 53.0 |
| Commercial entities | 0.7 | 0.9 | 0.8 | 1.1 |
| Total revenue | 100.0% | 100.0% | 100.0% | 100.0% |

We derived a substantial majority of our revenues from governmental contracts under which we act as a prime contractor. We also provide services indirectly as a subcontractor. The following table shows our revenues as prime contractor and as subcontractor as a percentage of our total revenue for the following periods:

| | Three Months Ended | | Nine Months Ended | |
|------------------------|--------------------|---------------|-------------------|---------------|
| | Sept 27, 2008 | Sept 29, 2007 | Sept 27, 2008 | Sept 29, 2007 |
| Prime contract revenue | 86.4% | 77.4% | 85.4% | 78.5% |
| Subcontract revenue | 13.6 | 22.6 | 14.6 | 21.5 |
| Total revenue | 100.0% | 100.0% | 100.0% | 100.0% |

Our services are provided to clients pursuant to three types of contracts: cost reimbursable, time and materials and fixed price contracts. The following table shows our revenues from each of these types of contracts as a percentage of our total revenue for the following periods:

| | Three Months Ended | | Nine Months Ended | |
|--------------------|--------------------|---------------|-------------------|---------------|
| | Sept 27, 2008 | Sept 29, 2007 | Sept 27, 2008 | Sept 29, 2007 |
| Cost reimbursable | 32.0% | 25.8% | 27.9% | 28.7% |
| Time and materials | 33.7 | 36.3 | 35.5 | 34.8 |
| Fixed price | 34.3 | 37.9 | 36.6 | 36.5 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |

Our cost reimbursable revenues, as a percentage of total revenues, increased primarily due to higher equipment pass-through revenue on our C4I2TSR program as well as an increase in efforts under a new program with an intelligence agency.

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

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Revenues on time and materials contracts are recognized based on direct labor hours expended at contract billing rates and adding other billable direct costs. To the extent that our actual labor costs under a time and materials contract are higher or lower than the billing rates under the contract, our profit under the contract may either be greater or less than we anticipated or we may suffer a loss under the contract. We recognize revenues under time and materials contracts by multiplying the number of direct labor hours expended by the contract billing rates and adding the effect of other billable direct costs.

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

Table of Contents

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

Contract revenue recognition inherently involves estimation, including the contemplated level of effort to accomplish the tasks under contract, the cost of the effort, and an ongoing assessment of progress toward completing the contract. From time to time, as part of the normal management processes, facts develop that require revisions to estimated total costs or revenues expected. The cumulative impact of any revisions to estimates and the full impact of anticipated losses on contracts accounted for under SOP 81-1 are recognized in the period in which they become known. Losses on all other contracts are recognized as the services and materials are provided.

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

Liquidity and Capital Resources

General. Short-term liquidity requirements are created by our use of funds for working capital, capital expenditures, and the need to provide debt service. We expect to meet these requirements through a combination of cash flow from operations and borrowings under our Second Amended Credit Agreement.

We anticipate that our long-term liquidity requirements, including any further acquisitions, will be funded through a combination of cash flow from operations, borrowings under our Second Amended Credit Agreement, additional secured or unsecured debt or the issuance of common or preferred stock, each of which may be initially funded through borrowings under our Second Amended Credit Agreement.

Under the terms of our Second Amended Credit Agreement, the Company is required to maintain compliance with financial and non-financial covenants. The Company is in compliance with all such covenants as of September 27, 2008.

Cash and Cash Equivalents. We consider cash on deposit and all highly liquid investments with original maturities of three months or less to be cash and cash equivalents. Cash and cash equivalents as of September 27, 2008 and December 29, 2007 were \$1.2 million and \$13.1 million, respectively.

Cash Flow. The following table sets forth our sources and uses of cash and cash equivalents for the nine months ended September 27, 2008 and September 29, 2007:

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| | Nine Months Ended | |
|---|-------------------|------------------|
| | Sept 27, 2008 | Sept 29, 2007 |
| | (in thousands) | |
| Net cash provided by operations | \$ 14,919 | \$ 12,653 |
| Net cash used in investing activities | (2,166) | (71,049) |
| Net cash (used in) provided by financing activities | (24,670) | 45,737 |
| Net decrease in cash and cash equivalents | \$ (11,917) | \$ (12,659) |

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 bill most of our clients monthly after services are rendered. Cash provided by operations for the nine months ended September 27, 2008 was attributable to net income of \$10.3 million, plus depreciation, amortization and other non-cash items of \$8.2 million, and a decrease in working capital and other operation assets and liabilities of \$3.6 million. Cash provided by operations in the nine months ended September 29, 2007 was attributable to net income of \$14.1 million, plus depreciation, amortization and other non-cash items of \$6.9 million, offset by an increase in working capital and other operating assets and liabilities of \$8.4 million.

Our cash flow used in investing activities consists primarily of capital expenditures, the purchase and sale of marketable securities, and acquisitions. In the nine months ended September 27, 2008, we purchased capital assets totaling \$2.2 million. During the nine months ended September 29, 2007, we paid \$60.4 million for the LOGTEC acquisition, net of cash assumed, repaid \$6.0 million of note payable to the former owners of Zen, and invested \$4.7 million in capital assets. We partially offset the cash use with \$7.8 million of proceeds from the sale of marketable securities, net of purchases.

Table of Contents

Our cash flow from financing activities consists primarily of borrowings under and payments on our credit facility and proceeds from the issuance and exercise of common stock, and payment for repurchase of common stock under our stock repurchase program. For the nine months ended September 27, 2008, cash flow used in financing activities consists of repayment of the line of credit and term loan portions under our prior and current credit facilities of \$129.3 million, repurchase of common stock of \$11.9 million, and debt issuance costs of \$0.9 million, partially offset by the proceeds of \$0.7 million from the exercise of stock options, plus proceeds of our credit facility refinancing of \$116.8 million. Cash provided by financing activities for the nine months ended September 29, 2007 consists of borrowings of \$25.0 million under the newly amended term loan, borrowings of \$25.0 million under the revolving line of credit, and proceeds of \$1.6 million from the exercise of stock options. These were partially offset by a \$5.0 million repayment of our revolving line of credit and \$0.9 million of repayments of the term loan portion of our credit facility and capital leases.

Results of Operations

The following table sets forth certain items from our consolidated statements of operations as a percentage of revenues for the periods indicated:

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|------------------|-------------------|------------------|
| | Sept 27, 2008 | Sept 29, 2007 | Sept 27, 2008 | Sept 29, 2007 |
| Revenue | 100.0% | 100.0% | 100.0% | 100.0% |
| Operating costs and expenses: | | | | |
| Cost of services | 67.3 | 65.8 | 66.4 | 63.5 |
| Selling, general and administrative | 26.7 | 25.8 | 26.8 | 27.4 |
| Depreciation and amortization | 0.7 | 0.7 | 0.8 | 0.7 |
| Amortization of intangible assets | 0.7 | 1.0 | 0.8 | 0.8 |
| Total operating costs and expenses | 95.4 | 93.3 | 94.8 | 92.4 |
| Income from operations | 4.6 | 6.7 | 5.2 | 7.6 |
| Interest expense, net | (1.1) | (1.6) | (1.2) | (1.4) |
| Income before provision for income taxes | 3.5 | 5.1 | 4.0 | 6.2 |
| Provision for income taxes | 1.4 | 2.0 | 1.6 | 2.4 |
| Net income | 2.1% | 3.1% | 2.4% | 3.8% |

Three months ended September 27, 2008 compared with three months ended September 29, 2007

Revenue. For the three months ended September 27, 2008, our revenues increased 5.5% to \$148.9 million from \$141.1 million for the three months ended September 29, 2007. Revenues from work under Federal Government contracts increased 5.9% to \$148.0 million for the three months ended September 27, 2008 from \$139.8 million for the three months ended September 29, 2007. This increase was primarily attributable to new contract awards, successful recompetition wins on existing programs, new contracts from and growth within existing programs in our four focus areas: Federal IT Modernization, Defense Transformation, Homeland Defense, and Mission-Critical Outsourcing. We continue to focus primarily on opportunities for the Federal Government.

Cost of services. Cost of services include direct labor and other direct costs such as materials and subcontractor costs, incurred to provide our services and solutions to our customers. Generally, changes in costs of services are correlated to changes in revenue as resources are consumed in the production of that revenue. For the three months ended September 27, 2008, cost of services increased 8.0% to \$100.3 million from

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\$92.9 million for the three months ended September 29, 2007. This increase was attributable primarily to the increase in revenue. As a percentage of revenue, cost of services was 67.3% for the three months ended September 27, 2008 as compared to 65.8% for the three months ended September 29, 2007. The increase in cost of services, as a percentage of revenue, is due primarily to the Company increasing its use of subcontractors on programs for which we are acting as the prime contractor and higher costs during the quarter related to certain fixed price contracts.

Selling, general and administrative expenses. Selling, general and administrative expenses include facilities, selling, bid and proposal, indirect labor, fringe benefits and other discretionary costs. For the three months ended September 27, 2008, indirect costs increased 9.0% to \$39.8 million from \$36.5 million for the three months ended September 29, 2007. This \$3.3 million increase was primarily attributable to the expected growth of support functions necessary to facilitate and administer the growth in direct costs. As a percentage of revenue, selling, general and administrative costs were 26.7% for the three months ended September 27, 2008 as compared to 25.8% for the three months ended September 29, 2007. The increase of 0.9% is primarily due to approximately \$1.5 million of costs to outside consultants related to the pending acquisition of the Company.

Table of Contents

Depreciation and amortization. Depreciation and amortization includes the depreciation of computers, furniture and other equipment, the amortization of third party software we use internally, and the depreciation of leasehold improvements. For the three months ended September 27, 2008, depreciation and amortization expense was \$1.0 million, an increase of 11.1% compared to \$0.9 million for the three months ended September 29, 2007. As a percentage of revenue, depreciation and amortization expense was 0.7% for the three months ended September 27, 2008 and September 29, 2007.

Amortization of intangible assets. Amortization of intangible assets includes the amortization of intangible assets acquired in connection with acquisitions. Identifiable intangible assets are amortized over their estimated useful lives. Non-compete agreements are generally amortized straight-line over the term of the agreement, while contracts and related client relationships are amortized using an accelerated method over their estimated useful lives. For the three months ended September 27, 2008, amortization of intangible assets was \$1.1 million, compared to \$1.4 million for the three months ended September 29, 2007. As a percentage of revenue, amortization of intangible assets was 0.7% for the three months ended September 27, 2008 compared to 1.0% for the three months ended September 29, 2007.

Income from operations. For the three months ended September 27, 2008, income from operations decreased 27.7% to \$6.8 million from \$9.4 million for the three months ended September 29, 2007. This decrease was attributable primarily to increased costs of services, as described above. As a percentage of revenue, income from operations was 4.6% for the three months ended September 27, 2008 compared to 6.7% for the three months ended September 29, 2007.

Interest expense, net. Interest expense, net was \$1.6 million for the three months ended September 27, 2008, a decrease of 27.3% compared to \$2.2 million in the quarter ended September 29, 2007. As a percentage of revenue, interest expense, net was 1.1% for the three months ended September 27, 2008 as compared to 1.6% for the three months ended September 29, 2007. The decrease in interest expense was due to both lower average borrowings along with a lower effective interest rate for the quarter ended September 27, 2008 as compared to the same period a year ago.

Provision for income taxes. The provision for income taxes was \$2.1 million in the three months ended September 27, 2008, compared to \$2.8 million for the three months ended September 29, 2007. Our third quarters of 2008 and 2007 tax provision, represent an estimated annual effective tax rate of 40.5%, and 39.2%, respectively. Our estimated annual effective tax rate of 40.5% for 2008 is greater than the federal statutory rate of 35% due primarily to state income taxes, the tax impact related to our non-qualified deferred compensation plan and certain non-deductible stock compensation costs. The tax impact of the nonqualified deferred compensation plan is based on an estimated return on the plan's assets. Actual results could differ from these estimates.

Nine months ended September 27, 2008 compared with nine months ended September 29, 2007

Revenue. For the nine months ended September 27, 2008, our revenues increased 14.1% to \$426.1 million from \$373.6 million for the nine months ended September 29, 2007. Revenues from work under Federal Government contracts increased 14.5% to \$422.9 million for the nine months ended September 27, 2008 from \$369.3 million for the nine months ended September 29, 2007. This increase was primarily attributable to the acquisition of LOGTEC, Inc., along with new contract awards, successful re-competition wins on existing programs, new contracts from and growth within existing programs in our four focus areas: Federal IT Modernization, Defense Transformation, Homeland Defense, and Mission-Critical Outsourcing. We continue to focus primarily on opportunities for the Federal Government.

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Cost of services. Cost of services include direct labor and other direct costs such as materials and subcontractor costs, incurred to provide our services and solutions to our customers. Generally, changes in costs of services are correlated to changes in revenue as resources are consumed in the production of that revenue. For the nine months ended September 27, 2008, cost of services increased 19.2% to \$283.0 million from \$237.5 million for the nine months ended September 29, 2007. This increase was attributable primarily to the increase in revenue. As a percentage of revenue, cost of services was 66.4% for the nine months ended September 27, 2008 as compared to 63.5% for the nine months ended September 29, 2007. The increase in cost of services, as a percentage of revenue, is due primarily to the Company increasing its use of subcontractors on programs for which we are acting as the prime contractor and higher costs during the quarter related to certain fixed price contracts.

Selling, general and administrative expenses. Selling, general and administrative expenses include facilities, selling, bid and proposal, indirect labor, fringe benefits and other discretionary costs. For the nine months ended September 27, 2008, indirect costs increased 11.8% to \$114.3 million from \$102.2 million for the nine months ended September 29, 2007. This \$12.1 million increase was primarily attributable to the expected growth of support functions necessary to facilitate and administer the growth in direct costs, as well as the integration of LOGTEC, Inc. As a percentage of revenue, selling, general and administrative costs were 26.8% for the nine months ended September 27, 2008 as compared to 27.4% for the nine months ended September 29, 2007.

Table of Contents

Depreciation and amortization. Depreciation and amortization includes the depreciation of computers, furniture and other equipment, the amortization of third party software we use internally, and the depreciation of leasehold improvements. For the nine months ended September 27, 2008, depreciation and amortization expense was \$3.2 million, an increase of 28.0% compared to \$2.5 million for the nine months ended September 29, 2007. As a percentage of revenue, depreciation and amortization expense was 0.8% for the nine months ended September 27, 2008 as compared to 0.7% for the nine months ended September 29, 2007.

Amortization of intangible assets. Amortization of intangible assets includes the amortization of intangible assets acquired in connection with acquisitions. Identifiable intangible assets are amortized over their estimated useful lives. Non-compete agreements are generally amortized straight-line over the term of the agreement, while contracts and related client relationships are amortized using an accelerated method over their estimated useful lives. For the nine months ended September 27, 2008, amortization of intangible assets was \$3.3 million, compared to \$2.9 million for the nine months ended September 29, 2007. As a percentage of revenue, amortization of intangible assets was 0.8% for the nine months ended September 27, 2008 and September 29, 2007.

Income from operations. For the nine months ended September 27, 2008, income from operations decreased 21.5% to \$22.3 million from \$28.4 million for the nine months ended September 29, 2007. This decrease was attributable primarily to increased costs of services, as described above. As a percentage of revenue, income from operations was 5.2% for the nine months ended September 27, 2008 compared to 7.6% for the nine months ended September 29, 2007.

Interest expense, net. Interest expense, net decreased 3.8% to \$5.0 million for the nine months ended September 27, 2008 from \$5.2 million for the nine months ended September 29, 2007. The decrease in interest expense was due to both lower average borrowings along with a lower effective interest rate for the nine months ended September 27, 2008 as compared to the same period a year ago. As a percentage of revenue, interest expense, net was 1.2% for the nine months ended September 27, 2008 as compared to 1.4% for the nine months ended September 29, 2007.

Provision for income taxes. The provision for income taxes was \$7.0 million in the nine months ended September 27, 2008, compared to \$9.1 million for the nine months ended September 29, 2007. Our third quarters 2008 and 2007 tax provision, represent an estimated annual effective tax rate of 40.5%, and 39.2%, respectively. Our estimated annual effective tax rate is greater than the federal statutory rate of 35% due primarily to state income taxes, the tax impact related to our non-qualified deferred compensation plan, and certain non-deductible stock compensation costs. The tax impact of the nonqualified deferred compensation plan is based on an estimated return on the plan's assets. Actual results could differ from these estimates.

Off-Balance Sheet Arrangements

As of September 27, 2008, we have no off-balance sheet arrangements that are reasonably likely to have a current or future material effect on our financial condition, revenues, or expenses, result of operations, liquidity, capital expenditures, or capital resources.

Critical Accounting Policies and Estimates

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Our significant accounting policies are described in Note 2 to our accompanying consolidated financial statements. We consider the accounting policies in this section to be critical to the understanding of our results of operations. Our critical accounting policies include the areas where we have made what we consider to be particularly difficult, subjective or complex judgments in making estimates, and where these estimates can significantly impact our financial results under different assumptions and conditions. We prepare our financial statements in conformity with U.S. generally accepted accounting principles. As such, we are required to make certain estimates, judgments and assumptions that we believe are reasonable based upon the information available. These estimates, judgments and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the periods presented. Actual results could be different from these estimates.

Revenue Recognition

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

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

Table of Contents

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

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

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

Contract revenue recognition inherently involves estimation, including the contemplated level of effort to accomplish the tasks under contract, the cost of the effort, and an ongoing assessment of progress toward completing the contract. From time to time, as part of the normal management processes, facts develop that require revisions to estimated total costs or revenues expected. The cumulative impact of any revisions to estimates and the full impact of anticipated losses on contracts accounted for under SOP 81-1 are recognized in the period in which they become known. Losses on all other contracts are recognized as the services and materials are provided.

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

Stock Based Compensation

Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123R, *Share Based Payment*, using the modified prospective transition method. Due to the use of the modified prospective method, prior interim periods and fiscal years do not reflect any restated amounts. The Company accelerated the vesting of unvested stock options previously awarded to employees, officers and directors in December 2005; thus the Company had no unvested stock options on January 1, 2006. Since January 1, 2006, the Company has issued 689,325 stock options and restricted stock awards through September 27, 2008. The total stock compensation expense recognized for stock options and restricted stock awards during the quarter ended September 27, 2008 was \$0.5 million. The total remaining unrecognized compensation expense related to the unvested options and restricted stock awards as of September 27, 2008 was \$3.6 million and \$3.1 million, respectively.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

We are exposed to certain financial market risks, the most predominant being fluctuations in interest rates for borrowings under our credit facility. Interest rate fluctuations are monitored by our management as an integral part of our overall risk management program, which recognizes the unpredictability of financial markets and seeks to reduce the potentially adverse effect on our results of operations. As part of this strategy, we may use interest rate swap arrangements to manage or hedge our interest rate risk. We evaluated the credit quality of potential counterparties to derivative transactions and only enter into agreements with those deemed to have minimal credit risk at the time the agreements are executed. We carefully monitor the amount of exposure we have with any given counterparty. We periodically monitor changes to counterparty credit as well as our concentration of credit exposure to individual counterparties. We do not use derivative financial instruments for speculative or trading purposes.

As of September 27, 2008, we had \$101.8 million outstanding under our Second Amended Credit Agreement. A 1% change in interest rates would have resulted in our interest expense fluctuating by approximately \$255,000 for the three months ended September 27, 2008.

Effective August 13, 2007, an interest swap agreement came into effect which reduced our exposure associated with the market volatility of floating LIBOR interest rates. This agreement has a notional principal amount of \$60.0 million and, as of September 27, 2008, had a fixed rate of 5.045%. This agreement is a hedge against term debt, which bears interest at LIBOR plus a margin which has a current rate of 3.94%. At stated monthly intervals the difference between the interest on the floating LIBOR-based debt and the interest calculated in the swap agreement are settled in cash. The estimated value of the swap at September 27, 2008 was a current liability of \$2.1 million.

Table of Contents

In addition, historically, our investment positions have been relatively small and short-term in nature. We have typically made investments in a fund with an effective average maturity of fewer than 40 days and a portfolio make-up consisting primarily of commercial paper and notes, variable rate instruments, and, to a lesser degree, overnight securities and bank instruments. Since our initial public offering, the Board of Directors approved an investment policy that requires us to invest in relatively short-term, high quality, and high liquidity obligations.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures. The Company performed an evaluation under the supervision and with the participation of management, including the Company's Chief Executive Officer and Chief Financial Officer, of the design and operation of the Company's disclosure controls and procedures as of September 27, 2008. Based upon the evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of September 27, 2008, the Company's disclosure controls and procedures were effective.

Changes in Internal Control Over Financial Reporting. During the quarter ended September 27, 2008, there were no changes in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control for financial reporting.

Table of Contents

PART II: OTHER INFORMATION

Item 1. Legal Proceedings

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

The Shenandoah Electronic Intelligence, Inc. (SEI) acquisition agreement provides for a purchase price adjustment based upon the working capital of SEI as of the closing date. Subsequent to the closing date, we received a payment of \$1.6 million in connection with services performed prior to the closing date that SEI had not previously billed, and was not authorized to bill, its customer as of the closing date. The SEI selling stockholders have asserted that they are entitled to a credit in connection with the calculation of working capital adjustment in an amount equal to the amount received by us for this post-closing payment. We believe that, in accordance with generally accepted accounting principles, the SEI selling stockholders should not receive the benefit of the post-closing payment. In accordance with the terms of the SEI acquisition agreement, the parties have jointly submitted the issue to an independent accounting firm for resolution. We anticipate that this matter will be resolved before the end of 2008.

From July 2001 through December 2007, the Company, through an acquired subsidiary, served as a subcontractor under a prime contract with the U.S. Department of Homeland Security and for the operation of the department's immigration service centers, including in Vermont (the SCOT Contract). In November 2007, the U.S. Department of Labor (DOL) initiated a compliance review with respect to the Service Contract Act (SCA) for the SCOT contract at the Vermont facility. The term of the SCOT Contract expired in November 2007. The period covered by the audit is from December 2005 through November 2007. We have held discussions with DOL concerning its preliminary findings; however, we are unable to determine an ultimate outcome of this matter at this time. The Company continues to cooperate with the DOL and to provide it with additional information. The Company believes that it has complied with the SCA requirements on the SCOT contract, and that the resolution of this matter will not have a material adverse effect to the Company. However, there can be no assurance that DOL will conclude that the Company has complied with the SCA requirements, or that any DOL finding of non-compliance will not result in a material adverse effect to the Company.

Item 1A. Risk Factors

There are no material updates to the risk factors previously disclosed in our Form 10-K for the year ended December 29, 2007.

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

The Company's Board of Directors authorized the repurchase of up to 1.0 million shares of common stock for up to an aggregate maximum dollar amount of \$25.0 million. Pursuant to the terms of a Rule 10b5-1 trading plan, the Company purchased shares of common stock as set

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forth on the table below:

| Month | Shares Purchased | Average Price per Share |
|--|-------------------------|--------------------------------|
| July 2008 | 146,468 | \$ 21.70 |
| August 2008 | 280,977 | \$ 20.44 |
| September 2008 | 20,700 | \$ 22.86 |
| Total for quarter ended September 27, 2008 | 448,145 | \$ 20.97 |
| Total shares purchased under the trading plan | 557,409 | \$ 21.39 |
| Total shares remaining to be purchased under trading plan | 442,591 | |

Although the trading plan was discontinued on August 27, 2008, a total of 20,700 repurchase shares were recorded as settling in September 2008 with the trades initiated prior to plan discontinuation.

Table of Contents

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

The exhibits required by this item are set forth on the Index to Exhibits attached hereto.

Table of Contents

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.

SI INTERNATIONAL, INC.

/s/ Thomas E. Dunn
Thomas E. Dunn
Executive Vice President and
Chief Financial Officer

Date: November 5, 2008

Table of Contents

INDEX TO EXHIBITS

| Exhibit No. | Description |
|--------------------|---|
| 2.1 | Agreement and Plan of Merger (the Merger Agreement) with Serco Group plc, Serco Inc. and Matador Acquisition Corporation, dated as of August 26, 2008 (filed as Exhibit 2.1 to the Company s Current Report on Form 8-K filed on August 27, 2008 and incorporated herein by reference). |
| 3.1 | Second Restated Certificate of Incorporation (filed as Exhibit 3.1 to the Company s Registration Statement on Form S-1/A (File No. 333-87964) filed on October 25, 2002 (the Third Amendment) and incorporated herein by reference). |
| 3.2 | Second Amended and Restated Bylaws, as amended (filed as Exhibit 3.2 to the Company s Current Report on Form 8-K filed on October 2, 2007 and incorporated herein by reference). |
| 4.1 | Registration Rights Agreement, as amended (filed as Exhibit 4.1 to the Third Amendment and incorporated herein by reference). |
| 4.2 | Specimen Certificate of our common stock (filed as Exhibit 4.2 to the Company s Registration Statement on Form S-1/A (File No. 333-87964) filed on November 5, 2002 (the Fourth Amendment) and incorporated herein by reference). |
| 4.3 | Stock Purchase Agreement, as amended (filed as Exhibit 4.3 to the Fifth Amendment and incorporated herein by reference). |
| 4.4 | Amendment to Stock Purchase Agreements (filed as Exhibit 4.4 to the Fourth Amendment and incorporated herein by reference). |
| 10.1 | 2002 Amended and Restated Omnibus Stock Incentive Plan (filed as Annex B to the Company s Proxy Statement on Schedule 14A for the 2005 Annual Meeting of Stockholders filed on April 21, 2005 and incorporated herein by reference). |
| 10.2 | January 2001 Nonqualified Stock Option Plan (filed as Exhibit 10.2 to the Company s Registration Statement on Form S-1/A (File No. 333-87964) filed on June 24, 2002 (the First Amendment) and incorporated herein by reference). |
| 10.3 | SI International, Inc. 2001 Service Award Stock Option Plan (filed as Exhibit 10.3 to the First Amendment and incorporated herein by reference). |
| 10.4 | 1998 Stock Option Plan (filed as Exhibit 10.5 to the First Amendment and incorporated herein by reference). |
| 10.5 | Non-Qualified Deferred Compensation Plan, as amended (filed as Exhibit 10.13 to the 2004 10-K and incorporated herein by reference). |
| 10.6 | Form of SI International, Inc. Stock Option Agreement Evidencing Grant of Stock Options Under the SI International, inc. 2002 Amended and Restated Omnibus Stock Incentive Plan, Including Notice of Stock Option Grant (filed as Exhibit 99.1 to the Company s Current Report on Form 8-K filed on March 17, 2005 and incorporated herein by reference). |
| 10.7 | Second Amended and Restated Credit Agreement, dated as of February 13, 2008 (filed as Exhibit 99.1 to the Company s Current Report on Form 8-K filed February 19, 2008 and incorporated herein by reference). |
| 10.8 | Amended and Restated Executive Employment Agreement with S. Bradford Antle (filed as Exhibit 10.10 to the Company s Quarterly Report on Form 10-Q filed on August 8, 2007 and incorporated herein by reference). |
| 10.9 | Amended and Restated Executive Employment Agreement with Thomas E. Dunn (filed as Exhibit 10.11 to the Company s Quarterly Report on Form 10-Q filed on August 8, 2007 and incorporated herein by reference). |
| 10.10 | Executive Employment Agreement with Thomas E. Lloyd (filed as Exhibit 10.9 to the Third Amendment and incorporated herein by reference). |
| 10.11 | Amended and Restated Executive Employment Agreement with Ray J. Oleson (filed as Exhibit 10.13 to the Company s Quarterly Report on Form 10-Q filed August 8, 2007 and incorporated herein by reference). |
| 10.12 | Executive Employment Agreement with Leslee H. Gault (filed as Exhibit 10.1 to the Company s Current Report on Form 8-K/A filed on October 2, 2006 and incorporated herein by reference). |
| 10.13 | Executive Employment Agreement with Harry D. Gatanas (filed as Exhibit 10.1 to the Company s Current Report on Form 8-K/A filed November 15, 2005 and incorporated herein by reference). |
| 10.14 | Executive Employment Agreement with Marylynn Stowers (filed as Exhibit 10.1 to the Company s Current Report on Form 8-K/A filed February 2, 2006 and incorporated herein by reference). |
| 10.15 | Executive Employment Agreement with P. Michael Becraft (filed as Exhibit 10.1 to the Company s Current Report on Form 8-K/A filed February 24, 2006 and incorporated herein by reference). |
| 10.16 | Consulting Services Agreement with Walter J. Culver (filed as Exhibit 10.12 to the 2004 10-K and incorporated herein by reference). |

Table of Contents

| Exhibit No. | Description |
|--------------------|---|
| 10.17 | Form of Indemnification Agreement (filed as Exhibit 10.11 to the Third Amendment and incorporated herein by reference). |
| 31.1 | Certifications of Chief Executive Officer and Chief Financial Officer pursuant to Rule 13a-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (*). |
| 32.1 | Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002 (*). |

* Indicates filed herewith.