SI INTERNATIONAL INC
Form 10-Q
August 03, 2005

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

ý	**QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTER ENDED JUNE 25, 2005**
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number

000-50080

SI International, Inc.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**52-2127278** (I.R.S. Employer Identification No.)
12012 Sunset Hills Road **Reston. Virginia** (Address of principal executive offices)	**20190-5869** (Zip Code)

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). ý Yes o No

As of August 1, 2005, there were 11,193,878 shares outstanding of the registrant s common stock.

SI INTERNATIONAL, INC.

FORM 10-Q

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PART II. **OTHER INFORMATION**

PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

SI International, Inc. and Subsidiaries

Consolidated Balance Sheets

(Amounts in thousands, except share and per share data)

		June 25, 2005 (Unaudited)		December 25, 2004
Assets				
Current assets:				
Cash and cash equivalents	$	14,932	$	5,754
Accounts receivable, net		74,463		65,710
Deferred tax asset		2,740		2,740
Other current assets		4,962		3,503
Total current assets		97,097		77,707
Property and equipment, net		4,536		4,971
Intangible assets, net		17,708		6,575
Other assets		5,681		2,142
Goodwill		173,876		120,712
Total assets	$	298,898	$	212,107
Liabilities and stockholders equity				
Current liabilities:				
Note Payable Line of Credit	$		$	28,954
Current portion of long-term debt		1,000		
Accounts payable		13,433		11,225
Accrued expenses and other current liabilities		20,089		15,314
Deferred revenue				289
Note payable former owner of acquired business		2,280		
Total current liabilities		36,802		55,782
Long-term debt, net of current portion		99,000		
Note payable former owner of acquired business				2,280
Deferred income tax		5,046		5,046
Other long-term liabilities		4,268		3,929
Stockholders equity:				
Common stock $0.01 par value per share; 50,000,000 shares authorized; 11,167,894 and 11,047,533 shares issued and outstanding as of June 25, 2005 and December 25, 2004, respectively		112		111
Additional paid-in capital		129,568		128,192
Deferred compensation		(133)		(208)
Retained earnings		24,235		16,975
Total stockholders equity		153,782		145,070
Total liabilities and stockholders equity	$	298,898	$	212,107

See accompanying notes

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SI International, Inc. and Subsidiaries

Consolidated Statements of Operations

(Amounts in thousands, except per share data)

Unaudited

	Three Months Ended		Six Months Ended	
	June 25, 2005	**June 26, 2004**	**June 25, 2005**	**June 26, 2004**
Revenue	$ 95,983	$ 63,814	$ 179,700	$ 119,784
Costs and expenses:				
Direct costs	58,598	38,801	111,201	72,330
Indirect costs	27,929	19,049	51,509	36,358
Depreciation and amortization	531	598	1,082	1,187
Amortization of intangible assets	611	192	1,068	306
Total operating expenses	87,669	58,640	164,860	110,181
Income from operations	8,314	5,174	14,840	9,603
Other income (expense)	14		(85)	
Interest expense	(1,659)	(738)	(2,756)	(1,272)
Income before provision for income taxes	6,669	4,436	11,999	8,331
Provision for income taxes	2,633	1,752	4,739	3,291
Net income	$ 4,036	$ 2,684	$ 7,260	$ 5,040
Earnings per common share:				
Basic net income per common share	$ 0.36	$ 0.32	$ 0.65	$ 0.60
Diluted net income per common share	$ 0.35	$ 0.30	$ 0.62	$ 0.56
Basic weighted-average shares outstanding	11,131	8,473	11,097	8,465
Diluted weighted-average shares outstanding	11,650	9,008	11,638	8,926

See accompanying notes

SI International, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(Amounts in thousands)

Unaudited

	Six Months Ended	
	June 25, 2005	June 26, 2004
Cash flows from operating activities:		
Net income	$ 7,260	$ 5,040
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,082	1,187
Amortization of intangible assets	1,068	306
Loss on disposal of fixed assets	9	
Deferred income tax provision		1,371
Stock-based compensation	62	66
Amortization of deferred financing costs	288	226
Changes in operating assets and liabilities, net of effect of acquisitions:		
Accounts receivable, net	3,724	(11,164)
Other current assets	(1,360)	(1,047)
Other assets	(658)	(502)
Accounts payable and accrued expenses	2,152	(671)
Deferred revenue	(289)	(49)
Other long term liabilities	934	1,223
Net cash provided by (used in) operating activities	14,272	(4,014)
Cash flows from investing activities:		
Purchase of property and equipment, net	(333)	(803)
Cash paid for acquisition of MATCOM International Corp.	(82)	(66,065)
Cash paid for acquisition of Bridge Technology Corporation	(133)	
Cash paid for acquisition of Shenandoah Electronic Intelligence, Inc., net of cash assumed	(73,758)	
Net cash used in investing activities	(74,306)	(66,868)
Cash flows from financing activities:		
Proceeds from exercise of stock options	1,389	285
Proceeds from bank overdrafts		2,872
Net (repayments) borrowings under line of credit	(28,954)	16,000
Proceeds from long-term debt	100,000	30,000
Payments of debt issuance costs	(3,170)	(1,201)
Repayments of capital lease obligations	(53)	(70)
Net cash provided by financing activities	69,212	47,886
Net change in cash and cash equivalents	9,178	(22,996)
Cash and cash equivalents, beginning of period	5,754	23,252
Cash and cash equivalents, end of period	$ 14,932	$ 256
Supplemental disclosures of cash flow information:		
Cash payments for interest	$ 1,916	$ 793
Cash payments for income taxes	$ 2,458	$ 2,788

See accompanying notes

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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 accounting principles generally accepted in the United States 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 accounting principles generally accepted in the United States 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 and six months ended June 25, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005. 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 25, 2004. References to the Company, we, us and our refer to SI International, Inc. and its subsidiaries.

2. Summary of significant accounting policies:

Principles of consolidation

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

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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, and our fiscal quarters end on the Saturday nearest but prior to the applicable quarterly month end. As a result, our fiscal year may be comprised of 52 or 53 weeks. The fiscal quarters and six-month periods presented in this Form 10-Q include 13 weeks and 26 weeks, respectively.

Cash and cash equivalents

The Company considers all investments with maturities of three months or less at the date of purchase to be cash equivalents.

Revenue Recognition

Our accounting policy regarding revenue recognition complies with the following criteria: (1) a contract has been executed; (2) the contract price is fixed and determinable; (3) delivery of services or products has occurred; and (4) collectibility is considered probable and can be reasonably estimated. Compliance with these criteria may require us to make significant judgments and estimates.

Significant customers

Revenue generated from contracts with the Federal government or prime contractors doing business with the Federal government accounted for a significant percent of revenues in the fiscal quarter and six months ending June 25, 2005 and June 26, 2004.

	Three Months Ended		Six Months Ended	
	June 25, 2005	June 26, 2004	June 25, 2005	June 26, 2004
Department of Defense	44.2%	52.3%	46.2%	51.2%
Federal civilian agencies	54.3	44.3	52.0	45.1
Commercial entities	1.5	3.4	1.8	3.7
Total revenue	100.0%	100.0%	100.0%	100.0%

For the three and six months ended June 25, 2005 we had two contracts that generated more than 10% of our revenue. Our C4I2SR contract with the U.S Air Force Space Command represented approximately 17.2% and 17.9% of our revenue, respectively. Our SCOT contract with the Department of Homeland Security represented approximately 10.4% of revenue for the three months ended June 25, 2005. We acquired this contract as part of our acquisition of Shenandoah Electronic Intelligence, Inc. (SEI). The SCOT contract did not represent more than 10% of our revenue for the first six months of 2005, in part because our acquisition of SEI was not consummated until February 2005. For the three and six months ended June 26, 2004, we had two contracts that generated more than 10% of our revenue. Our C4I2SR contract with the U.S Air Force Space Command represented approximately 13.5% of revenue for the first three months of 2004 and 12.2% of revenue for the first six months of 2004. Our National Visa Center contract with the Department of State represented approximately 9.7% of total revenue for the first three months of 2004 and 10.0% of total revenue for the first six months of 2004.

Deferred financing costs

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

	June 25, 2005	December 25, 2004
Deferred loan costs	$ 4,908	$ 1,737
Accumulated amortization	(1,125)	(837)
	$ 3,783	$ 900

Fair value of financial instruments

The Company s financial instruments consist primarily of cash and cash equivalents, accounts receivable, accounts payable, credit facilities, and notes payable. In management s opinion, the carrying amounts of these financial instruments approximate their fair values at June 25, 2005 and December 25, 2004.

Stock-based compensation

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure an amendment of SFAS 123. This statement amends SFAS No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company has chosen to continue to account for stock-based compensation using the intrinsic value method prescribed in APB Opinion No. 25 and related interpretations. Accordingly, compensation expense for stock options is measured as the excess, if any, of the fair market value of the Company s stock at the date of the grant over the exercise price of the related option. The Company has adopted the annual disclosure provisions of SFAS No. 148 in its financial reports for the year ended December 25, 2004 and has adopted the interim disclosure provisions for its financial reports for the quarter and six months ended June 25, 2005.

	Three Months Ended		Six Months Ended	
	June 25, 2005	June 26, 2004	June 25, 2005	June 26, 2004
Net income - as reported	$ 4,036	$ 2,684	$ 7,260	$ 5,040
Add: total stock-based employee compensation expense as reported under intrinsic value method (APB No. 25) for all awards, net of tax	19	20	38	40
Deduct: Total stock-based compensation expense determined under fair value based method (SFAS No. 123) for all awards, net of tax	(734)	(516)	(1,376)	(1,039)
Net income - pro forma	$ 3,321	$ 2,188	$ 5,922	$ 4,041
Basic earnings per share - as reported	$ 0.36	$ 0.32	$ 0.65	$ 0.60
Diluted earnings per share - as reported	$ 0.35	$ 0.30	$ 0.62	$ 0.56
Basic earnings per share - pro forma	$ 0.30	$ 0.26	$ 0.53	$ 0.48
Diluted earnings per share - pro forma	$ 0.29	$ 0.24	$ 0.51	$ 0.45

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 gives 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 000s):

	Three Months Ended		Six Months Ended	
	June 25, 2005	June 26, 2004	June 25, 2005	June 26, 2004
Net Income - Basic and Diluted	$ 4,036	$ 2,684	$ 7,260	$ 5,040
Weighted average share calculation:				
Basic weighted average shares outstanding	11,131	8,473	11,097	8,465
Treasury stock effect of stock options	519	535	541	461
Diluted weighted average shares outstanding	11,650	9,008	11,638	8,926

Reclassifications

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

New accounting pronouncements

In December 2004, the FASB issued FASB Statement No. 123(R) (revised 2004), *Share Based Payment.* Statement 123(R) addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise s equity instruments or that may be settled by the issuance of such equity instruments. Statement 123(R) requires an entity to recognize the grant-date fair-value of stock options and other equity-based compensation issued to employees in the income statement. The revised Statement generally requires an entity account for those transactions using the fair-value-based method, and eliminates the intrinsic value method of accounting in APB Opinion No. 25, *Accounting for Stock Issued to Employees*, which was permitted under Statement 123, as originally issued. The revised Statement requires entities to disclose information about the nature of the share-based payment transactions and the effects of those transactions on the financial statements. Statement 123(R) is effective for the Company as of its fiscal year beginning January 1, 2006. All public companies must use either the modified prospective or the modified retrospective transition method.

As permitted by Statement 123, the Company currently accounts for share-based payments to employees using Opinion 25 s intrinsic value method and, as such, generally recognizes no compensation cost for employee stock options. Accordingly, the adoption of Statement 123(R) s fair value method will have a significant impact on our results of operations, although it will have no impact on our overall financial position. The impact of adoption of Statement 123(R) cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, had we adopted Statement 123(R) in prior periods, the impact of that standard would have approximated the impact of Statement 123 as described in the disclosure of pro forma net income and earnings per share in the Stock-Based Compensation section of this note to our consolidated financial statements. Statement 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption.

3. Acquisitions:

On February 9, 2005, we completed the purchase of Shenandoah Electronic Intelligence, Inc. (SEI). SEI is a provider of critical business process outsourcing primarily for the Department of Homeland Security (DHS). SEI s services include: data and records management; applications processing; file and mail management; analytical support services; and secure optical card processing.

As a result of this acquisition, we gained approximately 1,700 additional employees and increased our leased space to 28 offices and three warehouses at various U.S. locations for an aggregate of approximately 536,263 square feet in 15 states (including approximately 27,090 square feet that are sub-leased through the remaining terms of our primary leases).

Under the terms of the definitive stock purchase agreement, we acquired SEI for $75 million in cash, subject to certain adjustments totaling approximately $0.6 million. The transaction was funded through cash-on-hand and borrowings from a new $160 million credit facility, which replaced the Company s previous $80 million credit facility. The purchase price is subject to adjustment as a result of certain tax elections. The definitive stock purchase agreement also provides that the SEI stockholders will retain certain non-operating assets and contingent accounts receivable.

Approximately $53.3 million of the purchase consideration has been allocated to goodwill based primarily on the excess of the purchase price over the estimated fair value of net assets acquired, and approximately $12.2 million of the purchase price has been assigned to identifiable intangible assets on the basis of contractual customer relationships. The $53.3 million allocated to goodwill takes into account an adjustment of approximately $1.4 million recorded during the second quarter of fiscal 2005. The contractual customer relationships are being amortized using an accelerated method over their estimated remaining life of 14 years.

The total purchase price paid, including transaction costs of $1.0 million, has been preliminarily allocated as follows (in thousands):

Cash	$	2,958
Accounts receivable		12,093
Prepaid expense and other current assets		353
Property and equipment		331
Accounts payable & accrued expenses		(4,678)
Contractual customer relationships		12,200
Goodwill		53,316
Total consideration	$	76,573

On December 20, 2004, the Company completed the purchase of Bridge Technology Corporation, a provider of information technology and information management. The acquisition supports the company s strategic growth plan to broaden its customer base into the intelligence agencies, and strengthen its portfolio of mission-critical solutions. Under the terms of the acquisition agreement, the Company acquired Bridge Technology for $30 million, subject to working capital and other adjustments totaling approximately $1.7 million. Of the purchase price, $29.4 million was paid in cash and the $2.3 million was held as note payable to be paid in June, 2006. Approximately $26.1 million of the purchase consideration has been allocated to goodwill, and approximately $2.2 million of the purchase price has been assigned to identifiable intangible assets on the basis of contractual customer relationships. The contractual customer relationships are being amortized using an accelerated method over their estimated remaining life of 6 years.

On January 21, 2004, the Company completed the purchase of MATCOM International Corp., a provider of information technology, systems engineering, logistics, and training. Under the terms of the merger agreement, the Company acquired MATCOM for $65.8 million. Approximately $54.6 million of the purchase consideration has been allocated to goodwill, and approximately $5.0 million of the purchase price has been assigned to identifiable intangible assets on the basis of contractual customer relationships. The contractual customer relationships are being amortized using an accelerated method over their estimated remaining life of 11 years.

The following unaudited proforma combined condensed statements of operations (in thousands, except per share) set forth the consolidated results of operations of the Company for the three and six months ended June 25, 2005 and June 26, 2004 as if the above described acquisitions had occurred at the beginning of each period presented. This unaudited proforma information does not purport to be indicative of the actual results that would actually have occurred if the combination had been in effect for the three and six months ended June 25, 2005 and June 26, 2004.

	Three Months Ended		Six Months Ended	
	June 25, 2005	June 26, 2004	June 25, 2005	June 26, 2004
Revenue	$ 95,983	$ 87,199	$ 188,126	$ 168,057
Net income	$ 4,036	$ 2,858	$ 7,240	$ 6,259
Diluted earnings per share	$ 0.35	$ 0.32	$ 0.62	$ 0.70

In accordance with the purchase accounting method, the operations of the MATCOM, Bridge Technology and SEI have been included in the Company s statements of operations since the respective dates of acquisition.

4. Accounts receivable:

Accounts receivable consists of the following (in thousands):

	June 25, 2005	December 25, 2004
Billed accounts receivable	$ 39,552	$ 33,247
Unbilled accounts receivable:		
Currently billable	30,232	26,400

Unbilled retainages and milestone payments expected to be billed within the next 12 months	5,336	5,714
Indirect costs incurred and charged to cost-plus contracts in excess of provisional billing rates	1,593	1,493
Total unbilled accounts receivable	37,161	33,607
Allowance for doubtful accounts	(2,250)	(1,144)
Accounts receivable, net	$ 74,463	$ 65,710

The currently billable amounts included as unbilled accounts receivable as of June 25, 2005 represent amounts that are billed during the following quarter of the current year. They are billings for services rendered prior to quarter-end, which are billed once necessary billing data has been collected and an invoice is produced.

5. **Property and equipment:**

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

	June 25, 2005	December 25, 2004
Computers and equipment	$ 8,392	$ 8,007
Software	2,020	1,904
Furniture and fixtures	1,617	1,576
Leasehold improvements	1,168	1,086
	13,197	12,573
Less Accumulated depreciation and amortization	(8,661)	(7,602)
Property and equipment, net	$ 4,536	$ 4,971

Property and equipment includes assets financed under capital lease obligations of approximately $248,000 and $332,000, net of accumulated amortization, as of June 25, 2005 and December 25, 2004, respectively.

6. **Accrued expenses and other current liabilities:**

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

	June 25, 2005	December 25, 2004
Accrued vacation	$ 6,538	$ 4,955
Accrued compensation	5,578	3,550
Accrued bonus	3,146	2,875
Other accrued liabilities	4,827	3,934
Accrued expenses and other current liabilities	$ 20,089	$ 15,314

7. **Debt:**

Debt, which is included in current and long term liabilities in the accompanying balance sheets, consists of the following (in thousands):

	June 25, 2005	December 25, 2004
Credit facilities:		
Line of credit at December 25, 2004, bears interest at LIBOR plus 275 to 350 basis points or a specified base rate plus 170 to 250 basis points, interest due	$	$ 28,954

monthly, principal due January 21, 2008				
Term loan at June 25, 2005, bears interest at LIBOR plus 225 to 250 basis points or a specified base rate plus 125 to 150 basis points, interest due monthly, twenty-three $250,000 consecutive quarterly principal payments starting on June 30, 2005, and a final $94.25 million principal payment on February 9, 2011		100,000		
Total debt	$	100,000	$	28,954

* Excludes $2.3 million note payable in connection with the Bridge Technology acquisition as described below.

Prior to the closing of the SEI acquisition, the credit facility (the 2004 credit facility) consisted of a $30.0 million term loan and a $50.0 million secured revolving credit arrangement. The 2004 credit facility was 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 of our existing and future subsidiaries. In addition, the Company was required to maintain compliance with financial and nonfinancial covenants, including the requirement to maintain certain leverage and fixed charge ratios, as defined in the credit agreement, as well as certain annual limits on our capital expenditures.

Contemporaneous with the closing of our acquisition of SEI on February 9, 2005, the Company amended and restructured its prior credit facility and increased its borrowing capacity to $160 million, which is comprised of a $60 million five-year revolving credit facility and a $100 million six-year term loan facility. Borrowings available under the amended credit facility were used to further the acquisitions of Bridge Technology and SEI. In addition, the amended and restructured credit facility provides that up to an additional $75 million in uncommitted incremental term loan funds are available to the Company upon its request at any time for up to two years from the amendment date from one or more of the lenders under the credit facility.

In connection with the amended credit facility, the Company incurred financing costs of $3.2 million. Such costs were capitalized as deferred financing costs on the balance sheet and are being amortized over the six year term of the new credit facility. As of June 25, 2005, the amounts outstanding under the term loan bore interest at LIBOR plus 250 basis points.

In connection with the Bridge Technology acquisition, the Company also has an outstanding note payable in the amount of $2.3 million, to be paid in June 2006, which is included in the accompanying balance sheet as Note payable   former owner of acquired business.

8. Commitments and contingencies:

Leases

As of June 25, 2005, the Company had noncancelable operating leases, primarily for real estate, that expire over the next ten years. Rental expense during the quarter ended June 25, 2005 was approximately $1.9 million, compared to rental expense of approximately $1.6 million during the quarter ended June 26, 2004.

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 provisional rates unless collectibility is reasonably assured for costs incurred at higher rates. To the extent the indirect rate differential creates a liability for the Company the differential is recognized as a reduction to revenue when identified.

Litigation and claims

From time to time, the Company is involved in litigation, claims and disputes that arise in the ordinary course of its business. In addition, the Company is subject to audit, review, and investigation by various agencies of the Federal government to determine compliance with applicable federal statutes and regulations. As a Federal government contractor, the Company is subject to audit by certain federal agencies to determine if the Company s performance and administration of its government contracts are compliant with contractual requirements and applicable federal statutes and regulations. While the Company cannot predict the ultimate outcome of legal proceedings, government audits, investigations, claims and disputes to which it is or may be subject, the Company currently believes, based upon information available to us as of the date of this filing, that any ultimate liability arising out of these matters will not have a material adverse effect on our financial position, results of operations, or cash flows.

9. Stockholders equity:

Stock option plan

In 2002, the Company adopted the 2002 Stock Incentive Plan, or the Plan to grant stock options to purchase up to 1,600,000 shares of its common stock to its employees and employees of its affiliates. In March 2004, the Board of Directors increased the number of reserved shares by 160,000, so that the total number of reserved shares totaled 1,760,000. In March 2005, the Board of Directors increased the number of reserved shares by an additional 160,000 so that the total number of reserved shares totals 1,920,000. Further, in March 2005, the Board of Directors authorized the acceleration of vesting of certain stock awards under the Plan upon the occurrence of certain change of control events. With this change, future stock awards may include provisions for acceleration of vesting upon the occurrence of certain change of control events. The Board of Directors also authorized the amendment of certain prior stock option awards issued under the Plan such that the exercise price of each such award was greater than or equal to the closing market price of our common stock on Nasdaq as of March 11, 2005. With respect to such designated prior stock option awards, the Board of Directors authorized an amendment to the stock option award to provide for the acceleration of vesting upon the occurrence of certain change of control events.

In April 2005, the Board of Directors voted to adopt the 2002 Amended and Restated Omnibus Stock Incentive Plan (the Amended and Restated Plan) and recommended the Amended and Restated Plan to the Company s stockholders for approval 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, (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 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.

During the fiscal quarter ended June 25, 2005, the Amended and Restated Plan was approved by our stockholders. As of June 25, 2005, the Company had issued and outstanding 1,536,459 stock options, and had 147,682 shares previously exercised pursuant to stock option grants, for a total of 1,684,141 shares exercised or stock options issued and outstanding under the Amended and Restated Plan against a ceiling of 2,920,000 shares of common stock authorized under this plan. As of June 25, 2005, the Company has issued and outstanding 127,022 stock options under stock option plans other than the Amended and Restated Plan. All such grants were made prior to the Company s initial public offering in November 2002, and no further grants will be made under these plans.

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 25, 2004. 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.

Our 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, and our fiscal quarter end on the Saturday nearest but prior to the applicable quarterly month end. As a result, our fiscal year may be comprised of 52 or 53 weeks. The fiscal quarters and six-month periods presented in this Form 10-Q include 13 weeks and 26 weeks, respectively.

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

Overview

We are a provider of information technology and network solutions to the Federal government. Our clients include U.S. Air Force Space Command, the Department of State, the U.S. Army, the Department of Homeland Security, Federal Retirement Thrift Investment Board, the National Institutes of Health, the Department of Agriculture, U.S. Air Force Electronic Systems Center, the U.S. Navy 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.

In the three and six months ended June 25, 2005, we received 98.5% and 98.2%, respectively, of our revenues from services we provided to various departments and agencies of the Federal government and 1.5% and 1.8%, respectively, of our total revenues from work performed for commercial entities. In comparison, for the three months and six months ended June 26, 2004, we received 96.5% and 96.3%, respectively, of our revenues from services we provided to Federal government agencies and 3.5% and 3.7%, respectively, of 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 includes revenue generated from work performed under engagements for both the Department of Defense and the intelligence community.

	Three Months Ended		Six Months Ended	
	June 25, 2005	June 26, 2004	June 25, 2005	June 26, 2004
Department of Defense	44.2%	52.2%	46.2%	51.2%
Federal civilian agencies	54.3%	44.3%	52.0%	45.1%
Commercial entities	1.5%	3.5%	1.8%	3.7%
Total revenue	100.0%	100.0%	100.0%	100.0%

We have 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. We intend to focus on retaining and increasing the percentage of our business as prime contractor because it provides us with stronger client relationships. 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		Six Months Ended	
	June 25, 2005	June 26, 2004	June 25, 2005	June 26, 2004

Prime contract revenue		73.6	%	80.4	%	74.9	%	79.9	%
Subcontract revenue		26.4	%	19.6	%	25.1	%	20.1	%
Total revenue		100.0	%	100.0	%	100.0	%	100.0	%

Our services are provided under 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		Six Months Ended	
	June 25, 2005	June 26, 2004	June 25, 2005	June 26, 2004
Cost reimbursable	27.0%	26.8%	27.9%	25.6%
Time and materials	45.2%	48.0%	45.6%	49.0%
Fixed price	27.8%	25.2%	26.5%	25.4%
Total	100.0%	100.0%	100.0%	100.0%

Under cost reimbursable contracts, we are reimbursed for costs that are determined to be reasonable, allowable and allocable to the contract, and paid a fee representing the profit margin negotiated between us and the contracting agency, which may be fixed or performance based. Under cost reimbursable contracts we recognize revenues and an estimate of applicable fees earned as costs are incurred. We consider fixed fees under cost reimbursable contracts to be earned in proportion to the allowable costs incurred in performance of the contract. For performance-based fees under cost reimbursable contracts, we recognize 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. In general, cost reimbursable contracts are the least profitable of our government contracts. In the three months and six months ended June 25, 2005, 27.0% and 27.9%, respectively, of our revenues were derived from cost reimbursable contracts. In the three and six months ended June 26, 2004, 26.8% and 25.6%, respectively, of our revenues were derived from cost reimbursable contracts.

Under time and materials contracts, we are reimbursed for labor at fixed hourly rates and generally reimbursed separately for allowable materials, costs and expenses. 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 be either 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. In general, we realize a higher profit margin on work performed under time and materials contracts than cost reimbursable contracts. In the three and six months ended June 25, 2005, 45.2% and 45.6%, respectively, of our revenues were derived from time and materials contracts. In the three and six months ended June 26, 2004, 48.0% and 49%, respectively, of our revenues were derived from time and material contracts.

Under fixed price contracts, we perform specific tasks for a fixed price. Compared to cost reimbursable and time and materials contracts, fixed price contracts generally offer higher profit margin opportunities but involve greater financial risk because we bear the impact of cost overruns in return for the full benefit of any cost savings. We generally do not undertake complex, high-risk work, such as long-term software development, under fixed price terms. Fixed price contracts may include either a product delivery or specific service performance over a defined period. Revenue on fixed price contracts that provide for the Company to render services throughout a period is recognized as earned according to contract terms as the service is provided on a proportionate performance basis. These contracts are generally less than six months in duration. For fixed price contracts that provide for the delivery of a specific product with related customer acceptance provisions, revenues are recognized as those products are delivered and accepted. In the three and six months ended June 25, 2005, 27.8% and 26.5%, respectively, of our revenues were derived from fixed price contracts. In the three and six months ended June 26, 2004, 25.2% and 25.4%, respectively, of our revenues were derived from fixed price contracts.

If we anticipate a loss on a contract, we provide for the full amount of anticipated loss at the time of that determination.

Our most significant expense is direct cost, which consists primarily of direct labor costs for program personnel and direct expenses incurred to complete contracts, including cost of materials and subcontractor costs. Our ability to predict accurately the number and types of personnel, their salaries, and other costs, can have a significant impact on our direct cost.

The allowability of certain direct and indirect costs in federal contracts is subject to audit by the client, usually through the DCAA. Certain indirect costs are charged to contracts and paid by the client using provisional, or estimated, indirect rates, which are subject to later revision, based on the government audits of those costs.

We actively monitor our relationships with our clients during our engagements, as well as the quality of the service we provide, to assist in our efforts to win recompetition bids. In addition, we strive to maintain good relationships with a wide variety of government contractors.

Results of Operations

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

	Three Months Ended				Six Months Ended			
	June 25, 2005		June 26, 2004		June 25, 2005		June 26, 2004	
Revenue	100.0	%	100.0	%	100.0	%	100.0	%
Costs and expenses:								
Direct costs	61.1		60.8		61.9		60.4	
Indirect costs	29.1		29.9		28.7		30.3	
Depreciation	0.6		0.9		0.6		1.0	
Amortization	0.6		0.3		0.6		0.3	
Total operating expenses	91.4		91.9		91.8		92.0	
Income from operations	8.6		8.1		8.2		8.0	
Interest expense	(1.7	)	(1.2	)	(1.5	)	(1.1	)
Income before provision for income taxes	6.9		6.9		6.7		6.9	
Provision for income taxes	2.7		2.7		2.7		2.7	
Net income	4.2	%	4.2	%	4.0	%	4.2	%

Three months ended June 25, 2005 compared with three months ended June 26, 2004

Revenue. For the three months ended June 25, 2005, our revenues increased 50.4% to $96.0 million from $63.8 million for the three months ended June 26, 2004. Revenues from work under Federal Government contracts increased 53.5% to $94.5 million for the three months ended June 26, 2004 from $61.6 million for the three months ended June 26, 2004. This increase was attributable to the acquisitions of MATCOM, Bridge Technology and SEI, 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. Commercial revenues decreased 34.1% to $1.5 million in the three months ended June 25, 2005 from $2.2 million in the three months ended June 26, 2004. This decrease was attributable to our continued focus on opportunities for the Federal government.

Direct costs. Direct costs include direct labor and other direct costs such as materials and subcontracts. Generally, changes in direct costs are correlated to changes in revenue as resources are consumed in the production of that revenue. For the three months ended June 25, 2005, direct costs increased 51.0% to $58.6 million from $38.8 million for the three months ended June 26, 2004. This increase was attributable primarily to the increase in revenue. As a percentage of revenue, direct costs were 61.1% for the three months ended June 25, 2005 as compared to 60.8% for the three months ended June 26, 2004.

Indirect costs. Indirect costs include facilities, selling, bid and proposal, indirect labor, fringe benefits and other discretionary costs. For the three months ended June 25, 2005, indirect costs increased 46.6% to $27.9 million from $19.0 million for the three months ended June 26, 2004. This $8.9 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

Bridge Technology and SEI. As a percentage of revenue, indirect costs were 29.1% for the three months ended June 25, 2005 as compared to 29.9% for the three months ended June 26, 2004.

Depreciation. For the three months ended June 25, 2005, depreciation expense decreased 11.2% to $0.5 million from $0.60 million for the three months ended June 26, 2004. As a percentage of revenue, depreciation expense was 0.6% for the three months ended June 25, 2005 compared to 0.9% for the three months ended June 26, 2004.

Amortization of intangible assets. For the three months ended June 25, 2005, amortization of intangible assets was $0.6 million, compared to $0.2 million for the three months ended June 26, 2004. This increase was attributed to the acquisition of Bridge Technology and SEI. The contractual customer relationships are being amortized using an accelerated method over their estimated remaining lives.

Income from operations. For the three months ended June 25, 2005, income from operations increased 60.7% to $8.3 million from $5.2 million for the three months ended June 26, 2004. This increase was attributable primarily to increased revenues. As a percentage of revenue, income from operations was 8.6% for the three months ended June 25, 2005 compared to 8.1% for the three months ended June 26, 2004.

Interest expense. Interest expense increased 124.8% to $1.66 million for the three months ended June 25, 2005 from $0.74 million for the three months ended June 26, 2004. This increase was attributable primarily to increased borrowings under our credit facility made in connection with the acquisitions of Bridge Technology and SEI. As a percentage of revenue, interest expense was 1.7% for the three months ended June 25, 2005 as compared to 1.2% for the three months ended June 26, 2004. We anticipate interest expense to remain at higher levels throughout fiscal year 2005 as compared to the same periods in 2004.

Provision for/benefit from income taxes. The provision for income tax was $2.6 million in the three months ended June 25, 2005, compared to $1.8 million for the three months ended June 26, 2004. Our second quarters of 2005 and 2004 tax provision, represents an estimated annual effective tax rate of 39.5%. Our estimated annual effective tax rate is greater than the federal statutory rate of 34% due primarily to state income taxes.

Six months ended June 25, 2005 compared with six months ended June 26, 2004

Revenue. For the six months ended June 25, 2005, our revenues increased 50.0% to $179.7 million from $119.8 million for the six months ended June 26, 2004. Revenues from work under Federal Government contracts increased 52.9% to $176.4 million for the six months ended June 25, 2005 from $115.4 million for the six months ended June 26, 2004. This increase was attributable to the acquisitions of MATCOM, Bridge Technology and SEI, 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. Commercial revenues decreased 25.0% to $3.3 million in the six months ended June 25, 2005 from $4.4 million in the six months ended June 26, 2004. The decrease was attributable primarily to increase in our focus on Federal Government support..

Direct costs. Direct costs include direct labor and other direct costs such as materials and subcontracts. Generally, changes in direct costs are correlated to changes in revenue as resources are consumed in the production of that revenue. For the six months ended June 25, 2005, direct costs increased 53.7% to $111.2 million from $72.3 million for the six months ended June 26, 2004. This increase was attributable primarily to the increase in revenue. As a percentage of revenue, direct costs were 61.9% for the six months ended June 25, 2005 as compared to 60.4% for the six months ended June 26, 2004.

Indirect costs. Indirect costs include facilities, selling, bid and proposal, indirect labor, fringe benefits and other discretionary costs. For the six months ended June 25, 2005, indirect costs increased 41.7% to $51.5 million from $36.4 million for the six months ended June 26, 2004. This $15.1 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 Bridge Technology and SEI. As a percentage of revenue, indirect costs were 28.7% for the six months ended June 25, 2005 as compared to 30.3% for the six months ended June 26, 2004.

Depreciation. For the six months ended June 25, 2005 was $1.1 million as compared to $1.2 million for the six months ended June 26, 2004. As a percentage of revenue, depreciation expense was 0.6% for the six months ended June 25, 2005 compared to 1.0% for the six months ended June 26, 2004.

Amortization of intangible assets. For the six months ended June 25, 2005, amortization of intangible assets was $1.1 million, compared to $0.3 million for the six months ended June 26, 2004. This increase was attributed to the acquisition of Bridge Technology and SEI. The contractual customer relationships are being amortized using an accelerated method over their estimated remaining lives.

Income from operations. For the six months ended June 25, 2005, income from operations increased 54.5% to $14.8 million from $9.6 million for the six months ended June 26, 2004. This increase was attributable primarily to the higher revenue. As a percentage of revenue, income from operations was 8.2% for the six months ended June 25, 2005 compared to 8.0% for the six months ended June 26, 2004.

Interest expense. Interest expense increased 116.7% to $2.76 million for the six months ended June 25, 2005 from $1.27 million for the six months ended June 26, 2004. This increase was attributable primarily to increased borrowings under our credit facility made in connection with the acquisitions of Bridge Technology and SEI. As a percentage of revenue, interest expense was 1.5% for the six months ended June 25, 2005 as compared to 1.1% for the six months ended June 26, 2004. We anticipate interest expense to remain at higher levels throughout fiscal year 2005 as compared to the same periods in 2004.

Provision for/benefit from income taxes. The provision for income tax was $4.7 million in the six months ended June 25, 2005, compared to $3.3 million for the six months ended June 26, 2004. Our first and second quarters of 2005 and 2004 tax provision, represents an estimated annual effective tax rate of 39.5%. Our estimated annual effective tax rate is greater than the federal statutory rate of 34% due primarily to state income taxes.

Liquidity and Capital Resources

Our primary liquidity needs are the financing of working capital, capital expenditures and acquisitions. We have historically relied primarily on cash flow from operations, borrowings under our credit facility and from some of our stockholders and the sale of common and preferred stock to provide for our cash needs.

Net cash provided by operations was $14.3 million for the six months ended June 25, 2005 compared with net cash used in operations of $4.0 million for the six months ended June 26, 2004. Cash provided by operations in the six months ended June 25, 2005 was attributable to net income of $7.3 million, depreciation, amortization, and other non-cash items of $2.5 million, and a decrease in working capital and other operating assets and liabilities of $4.5 million. Cash used in operations in the six months ended June 26, 2004 was attributable to net income of $5.0 million, depreciation, amortization and other non-cash items of $3.2 million, offset by an increase in net operating assets by $12.2 million.

Cash used in investing activities was $74.3 million for the six months ended June 25, 2005 compared with $66.9 million for the six months ended June 26, 2004. For the six months ended June 25, 2005, we acquired SEI, net of cash assumed, for $73.8 million and paid additional cash for the acquisitions of Bridge Technologies and MATCOM of $0.1 million and $0.1 million, respectively. We also invested $0.3 million in capital assets. For the six months ended June 26, 2004, we acquired MATCOM for $66.1 million, including certain transaction costs, and invested $0.8 million in capital assets.

Cash provided by financing activities was $69.2 million for the six months ended June 25, 2005, compared with $47.9 million for the six months ended June 26, 2004. Cash provided by financing activities for the six months ended June 25, 2005 was attributable to $100.0 million of long term debt provided by our credit facility and $1.4 million provided by proceeds from the exercise of stock options, partially offset by $29.0 million curtailment of our line of credit, $3.2 million of payments related to debt issuance costs and $53,000 of capital lease payments. Cash provided by financing activities for the six months ended June 26, 2004 was attributable to $16.0 million net borrowings under our revolving line of credit and $30.0 million of long-term debt provided by our credit facility, $2.9 million from bank overdrafts, and $0.3 million provided by proceeds from the exercise of stock options, partially offset by $1.2 million repayments of debt issuance fees, and $70,000 of capital lease payments.

Cash and cash equivalents as of June 25, 2005 and December 25, 2004 were $14.9 million and $5.8 million, respectively.

Debt consists of the following (in thousands):

	June 25, 2005	December 25, 2004
Credit facilities:		
Line of credit at December 25, 2004, bears interest at LIBOR plus 275 to 350 basis points or a specified base rate plus 170 to 250 basis points, interest due monthly, principal due January 21, 2008	$	$ 28,954
Term loan at June 25, 2005, bears interest at LIBOR plus 225 to 250 basis points or a specified base rate plus 125 to 150 basis points, interest due monthly, twenty-three $250,000 consecutive quarterly principal payments starting on June 30, 2005, and a final $94.25 million principal payment on February 9, 2011	100,000	
Total debt	$ 100,000	$ 28,954

* Excludes $2.3 million note payable in connection with the Bridge Technology acquisition as described below.

In connection with the acquisition of Bridge Technology and SEI, we amended our credit facility to increase the borrowing capacity from $80 million to $160 million and extended the term to February 9, 2011.

The amended credit facility includes a $100 million term loan and a $60 million revolving credit facility. Under the term loan, we are required to make twenty-three $250,000 quarterly principal payments starting on June 30, 2005 and a final $94.25 million principal payment on February 9, 2011.

The amended credit facility permits us, subject to our compliance with financial and nonfinancial covenants and customary conditions, to make up to $60 million of revolving credit borrowings and also provides for the issuance of letters of credit, although the amount of available revolving credit borrowings is reduced by the amount of any outstanding letters of credit issued under the facility.

Any borrowings outstanding under the amended credit facility will, at our option, bear interest either at floating rates equal to LIBOR plus a spread ranging from 200 to 275 basis points or a specified base rate plus a spread ranging from 100 to 175 basis points, with the exact spread determined upon the basis of our ratio of outstanding indebtedness to our earnings before interest, taxes, and depreciation and amortization expense, as defined in the new credit facility. As of June 25, 2005, the amounts outstanding under the term loan bore interest at LIBOR plus 250 basis points.

We and each of our existing and future subsidiaries are jointly and severally liable with respect to the payment of all borrowings and other amounts due and performance of all obligations under the new credit facility. The new 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 of our existing and future subsidiaries. The new credit facility requires us to make mandatory prepayments of outstanding borrowings, with a corresponding reduction in the maximum amount of borrowings available under the facility; net proceeds from certain insurance recoveries and asset sales, 100% of the net proceeds from debt issuances, and 50% of the net proceeds from certain equity issuances are subject to specified exceptions. Also, the new credit facility includes a number of restrictive covenants including, among other things, limitations on our leverage and capital expenditures, limitations on our ability to incur additional indebtedness or liens, requirements that we maintain minimum ratios of cash flow to fixed charges and prohibitions on payment of dividends on our capital stock, limitations on our ability to enter into mergers, acquisitions or sales of our assets, and prohibitions on certain transactions among our subsidiaries and affiliated companies. The new credit facility also contains events of default, including, among other events, any transaction resulting in a new stockholder or group of stockholders acquiring control of our board of directors or ownership of greater than 40% of our outstanding capital stock, any default by us under any material government contract or other material contract to which we are a party, and the suspension of our ability to enter into contracts with the federal, state or local governments generally.

We currently anticipate that cash flow from operations and borrowings available under our new credit facility will be sufficient to meet our presently anticipated capital needs for at least the next twelve months, but may be insufficient to provide funds necessary for any future acquisitions we may make, whether during the next twelve months or thereafter. To the extent that we require additional funds, whether for acquisitions or otherwise, we may seek additional equity or debt financing. As of June 25, 2005, approximately $44.9 million was available under the Company s shelf registration statement for the issuance of common stock, preferred stock, depositary shares, debt securities and warrants exercisable for common or preferred stock.

In connection with the Bridge Technology acquisition, the Company also has an outstanding note payable in the amount of $2.3 million, to be paid in June 2006, which is included in the accompanying balance sheet as a Note payable. former owner of acquired business.

Financial data for all of our subsidiaries are included in our consolidated financial statements.

Off-Balance Sheet Arrangements

As of June 25, 2005, 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

Our significant accounting policies are described in Note 2 to our accompanying consolidated financial statements. We consider the accounting policies related to revenue recognition to be critical to the understanding of our results of operations. Our critical accounting policies also 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 accounting principles generally accepted in the United States. 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

Our accounting policy regarding revenue recognition complies with the following criteria: (1) a contract has been executed; (2) the contract price is fixed and determinable; (3) delivery of services or products has occurred; and (4) collectibility of the contract price is considered probable and can be reasonably estimated. Compliance with these criteria may require us to make significant judgments and estimates.

For cost reimbursable contracts with fixed fees and fixed price contracts, we estimate the applicable fees earned as costs are incurred or services are provided. This process requires estimation of the contemplated level of effort to accomplish the tasks under contract and the cost of such effort, as well as ongoing assessment towards completing the contract. We utilize a number of management processes to monitor contract performance and revenue estimates, including monthly in-process reviews. For cost reimbursable contracts with performance-based fees, we estimate the applicable fees earned based on historical experience and performance evaluations from our customers. For fixed price contracts that are based on unit pricing, we recognize revenue for the number of units delivered in any given fiscal period. For fixed price contracts that are based on the proportionate performance method and involve a specified number of similar acts, we recognize revenue based on the proportion of those acts completed compared to the number of total specified acts required by the contract. For fixed price contracts that are based on the proportionate performance method and involve a specified number of defined but not similar acts, we recognize revenue based on the proportion of the project s percentage total costs incurred compared to the estimated total costs associated with the entire transaction. Occasionally, facts may develop that require revisions to estimated total costs or revenues expected. The cumulative effect of any such revisions is recorded in the period in which the facts requiring the revision become known. The full amounts of anticipated losses on any contract type are recognized in the period in which they become known.

In addition, certain indirect costs are charged to contracts and paid by the client using provisional, or estimated, indirect rates that are subject to later revision based on government audits. Any costs found to be improperly allocated to a specific contract will not be reimbursed, and any such costs already reimbursed must be refunded.

Stock Based Compensation

We account for stock-based compensation using the intrinsic value method prescribed in APB Opinion No. 25 and related interpretations. Accordingly, compensation expense for stock options is measured as the excess, if any, of the fair market value of the Company s stock at the date of the grant over the exercise price of the related option. We have adopted the annual disclosure provisions of SFAS No. 148 in our financial reports for the year ended December 25, 2004 and have adopted the interim disclosure provisions in our financial reports for the quarter ended June 25, 2005. The disclosures determine compensation cost for the Company s stock options based on SFAS No. 123, which reflects the fair value of each option estimated on the date of grant using the Black-Scholes option-pricing model.

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.

As of June 25, 2005, we had $100 million outstanding under our credit facility. A 1% change in interest rates would have resulted in our interest expense fluctuating by approximately $250,000 for the three months ended June 25, 2005.

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 June 25, 2005. Based upon the evaluation, the Company s Chief Executive Officer and Chief Financial Officer have concluded that, as of June 25, 2005, the Company s disclosure controls and procedures were effective.

Changes in Internal Control Over Financial Reporting. During the three months ended June 25, 2005, 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.

PART II: OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, the Company is involved in litigation, claims and disputes that arise in the ordinary course of its business. In addition, the Company is subject to audit, review, and investigation by various agencies of the Federal government to determine compliance with applicable federal statutes and regulations. As a Federal government contractor, the Company is subject to audit by certain federal agencies to determine if the Company s performance and administration of its government contracts are compliant with contractual requirements and applicable federal statutes and regulations. While the Company cannot predict the ultimate outcome of legal proceedings, government audits, investigations, claims and disputes to which it is or may be subject, the Company currently believes, based upon information available to us as of the date of this filing, that any ultimate liability arising out of these matters will not have a material adverse effect on our financial position, results of operations, or cash flows.

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

None.

Item 3. Defaults Upon Senior Securities

None.

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

During the fiscal quarter ended June 25, 2005, we submitted certain matters to a vote of our stockholders through the notice of annual meeting of stockholders and the solicitation of proxies related thereto. The proxy materials related to the Registrant s Second Annual Meeting of Stockholders were distributed on or about May 1, 2005 and the annual meeting of stockholders was held on June 16, 2005, in Reston, Virginia. As of the record date prior to such meeting, 11,119,850 shares of the Registrant s common stock were outstanding and entitled to vote at the meeting. At the annual stockholders meeting on June 16, 2005, 10,295,643 shares of the Registrant s common stock were present in person or by proxy, representing 92.59% of the outstanding shares of common stock of the Registrant.

The following sets forth the matters presented for a vote by the stockholders and the votes cast for, withheld, abstained, and broker non-votes:

Matter	Votes For	Votes Withheld	Abstentions	Broker Non-Votes
(1) Election of Mr. James E. Crawford III as a Class III director with a term serving until the 2008 Annual Meeting	9,231,511	1,064,132	0	0
(2) Election of Walter C. Florence as a Class III director with a term serving until the 2008 Annual Meeting	9,325,330	970,313	0	0
(3) Ratification of the appointment of Ernst & Young LLP as our independent auditors for the current fiscal year	10,249,797	39,036	6,810	0
(4) Approval of the 2002 Amended and Restated Omnibus Stock Incentive Plan	7,545,076	1,378,674	29,528	1,342,365

Item 5. Other Information

None.

Item 6. Exhibits

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

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: August 3, 2005

INDEX TO EXHIBITS

Exhibit No.	Description
2.1	Agreement and Plan of Merger among the Company, Link Acquisition Corporation, a Delaware corporation and a wholly-owned subsidiary of the Company, MATCOM International Corp., and the stockholders of MATCOM International Corp., dated as of December 17, 2003, as amended by the First Amendment to Agreement and Plan of Merger, dated as of January 21, 2004 (filed as Exhibit 2.1 to the Company s Current Report on Form 8-K filed January 28, 2004 and incorporated herein by reference). (The appendices and exhibits have been omitted pursuant to Item 601(b)(2) of Regulation S-K. SI International, Inc. hereby undertakes to furnish supplementally to the Securities and Exchange Commission copies of any omitted appendices and exhibits upon request by the Securities and Exchange Commission).
2.2	Agreement and Plan of Merger among the Company, Link Acquisition2 Corporation, a Delaware corporation and a wholly-owned subsidiary of the Company, Bridge Technology Corporation, and the stockholders of Bridge Technology Corporation, dated as of November 30, 2004 (filed as Exhibit 2.2 to the Company s Current Report on Form 10-K filed March 10, 2005 (the 2004 10-K) and incorporated herein by reference). (The appendices and exhibits have been omitted pursuant to Item 601(b)(2) of Regulation S-K. SI International, Inc. hereby undertakes to furnish supplementally to the Securities and Exchange Commission copies of any omitted appendices and exhibits upon request by the Securities and Exchange Commission.)
2.3	Stock Purchase Agreement among the Company, Shenandoah Electronic Intelligence, Inc. (SEI), and the stockholders of SEI dated January 12, 2005 (filed as Exhibit 99.1 to the Company s Current Report on Form 8-K filed March 1, 2005 and incorporated by reference). (The appendices and exhibits have been omitted pursuant to Item 601(b)(2) of Regulation S-K. SI International, Inc. hereby undertakes to furnish supplementally to the Securities and Exchange Commission copies of any omitted appendices and exhibits upon request by the Securities and Exchange Commission).
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	Amended and Restated Bylaws, as amended (filed as Exhibit 3.2 to the Company s Registration Statement on Form S-1/A (File No. 333-87964) filed on November 8, 2002 (the Fifth Amendment) 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	Form of 2002 Stock Incentive Plan (filed as Exhibit 10.1 to the Third Amendment 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 Amended and Restated Credit Agreement (filed as Exhibit 99.1 to the Company s Current Report on Form 8-K filed February 15, 2005 and incorporated herein by reference).

10.6 Executive Employment Agreement with S. Bradford Antle (filed as Exhibit 10.6 to the Third Amendment and incorporated herein by reference).

10.7 Executive Employment Agreement with Paul R. Brubaker (filed as Exhibit 99.1 to the Company s Current Report on Form 8-K filed March 22, 2005 and incorporated herein by reference).

10.8	Executive Employment Agreement with Thomas E. Dunn (filed as Exhibit 10.8 to the Third Amendment and incorporated herein by reference).
10.9	Executive Employment Agreement with Thomas E. Lloyd (filed as Exhibit 10.9 to the Third Amendment and incorporated herein by reference).
10.10	Executive Employment Agreement with Ray J. Oleson (filed as Exhibit 10.10 to the Third Amendment and incorporated herein by reference).
10.11	Form of Indemnification Agreement (filed as Exhibit 10.11 to the Third Amendment and incorporated herein by reference).
10.12	Consulting Services Agreement with Walter J. Culver (filed as Exhibit 10.12 to the 2004 10-K and incorporated herein by reference).
10.13	Non-Qualified Deferred Compensation Plan, as amended (filed as Exhibit 10.13 to the 2004 10-K and incorporated herein by reference).
10.14	SI International, Inc. 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 and incorporated herein by reference).
10.15	Form of SI International, inc. Stock Option Agreement Evidencing Grant of Stock Options Under the SI International, inc. 2002 Stock Inventive Plan, Including Notice of Stock Option Grant (filed as Exhibit 99.1 to the Company s Current Report on Form 8-K filed March 17, 2005 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.