

SI INTERNATIONAL INC
Form 10-Q
May 09, 2006

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 APRIL 1, 2006**

**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**

Edgar Filing: SI INTERNATIONAL INC - Form 10-Q

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, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

As of May 1, 2006, 12,828,159 shares outstanding of the registrant's common stock.

SI INTERNATIONAL, INC.

FORM 10-Q

INDEX

PART I.

FINANCIAL INFORMATION

Edgar Filing: SI INTERNATIONAL INC - Form 10-Q

ITEM 1

Financial Statements

Consolidated Balance Sheets at April 1, 2006 (unaudited) and December 31, 2005

Consolidated Statements of Operations for the three months ended April 1, 2006 and March 26, 2005 (unaudited)

Consolidated Statements of Cash Flows for the three months ended April 1, 2006 and March 26, 2005 (unaudited)

Notes to Consolidated Financial Statements

ITEM 2

Management's Discussion and Analysis of Financial Condition and Results of Operations

ITEM 3

Quantitative and Qualitative Disclosures About Market Risk

ITEM 4

Controls and Procedures

PART II.

OTHER INFORMATION

Edgar Filing: SI INTERNATIONAL INC - Form 10-Q

ITEM 1
ITEM 1A.
ITEM 2
ITEM 3
ITEM 4
ITEM 5
ITEM 6
Signatures
Index to Exhibits

Legal Proceedings
Risk Factors
Unregistered Sales of Equity Securities and Use of Proceeds
Defaults Upon Senior Securities
Submission of Matters to a Vote of Security Holders
Other Information
Exhibits

PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

SI International, Inc. and Subsidiaries

Consolidated Balance Sheets

(Amounts in thousands, except share data)

	April 1, 2006 Unaudited	December 31 2005
Assets		
Current assets:		
Cash and cash equivalents	\$ 13,256	\$ 26,160
Marketable securities		7,850
Accounts receivable, net	89,790	93,633
Deferred tax asset	422	422
Other current assets	11,692	6,276
Total current assets	115,160	134,341
Property and equipment, net	6,304	5,908
Intangible assets, net	22,886	16,483
Other assets	7,334	5,655
Goodwill	220,440	173,308
Total assets	\$ 372,124	\$ 335,695
Liabilities and stockholders' equity		
Current liabilities:		
Current portion of long-term debt	\$ 1,293	\$ 1,000
Accounts payable	15,773	25,364
Accrued expenses and other current liabilities	28,482	29,674
Note payable - former owner of acquired business	2,280	2,280
Total current liabilities	47,828	58,318
Long-term debt, net of current portion	127,634	98,250
Note payable - former owner of acquired business	5,517	
Deferred income tax	6,173	5,221
Other long-term liabilities	7,424	6,037
Stockholders' equity:		
Common stock \$0.01 par value per share; 50,000,000 shares authorized; 11,592,669 and 11,341,222 shares issued and outstanding as of April 1, 2006 and December 31, 2005, respectively	116	114
Additional paid-in capital	138,953	133,843
Accumulated other comprehensive income	253	
Retained earnings	38,226	33,912
Total stockholders' equity	177,548	167,869
Total liabilities and stockholders' equity	\$ 372,124	\$ 335,695

See accompanying notes

SI International, Inc. and Subsidiaries

Consolidated Statements of Operations

(Amounts in thousands, except per share data)

Unaudited

	Three Months Ended	
	April 1, 2006	March 26, 2005
Revenue	\$ 107,232	\$ 83,717
Costs and expenses:		
Direct costs	66,609	52,603
Indirect costs	30,546	23,580
Depreciation and amortization	548	551
Amortization of intangible assets	647	457
Total operating expenses	98,350	77,191
Income from operations	8,882	6,526
Other income (expense)	30	(99)
Interest expense	(1,782)	(1,097)
Income before provision for income taxes	7,130	5,330
Provision for income taxes	2,816	2,106
Net income	\$ 4,314	\$ 3,224
Earnings per common share:		
Basic net income per common share	\$ 0.38	\$ 0.29
Diluted net income per common share	\$ 0.36	\$ 0.28
Basic weighted-average shares outstanding	11,422	11,063
Diluted weighted-average shares outstanding	11,899	11,627

See accompanying notes

SI International, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(Amounts in thousands)

Unaudited

	Three Months Ended	
	April 1, 2006	March 26, 2005
Cash flows from operating activities:		
Net income	\$ 4,314	\$ 3,224
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	548	551
Amortization of intangible assets	647	457
Stock-based compensation		32
Change in fair value of interest rate swap	253	
Amortization of deferred financing costs	194	120
Changes in operating assets and liabilities, net of effect of acquisitions:		
Accounts receivable, net	14,465	1,699
Other current assets	(4,790)	(976)
Other assets	(1,389)	(454)
Accounts payable and accrued expenses	(16,734)	4,108
Other long term liabilities	2,397	732
Net cash provided by (used in) operating activities	(95)	9,493
Cash flows from investing activities:		
Purchase of property and equipment	(461)	(172)
Proceeds from sale of marketable securities	7,850	2,000
Former owner payable	(8,042)	
Cash paid for business acquisitions, net of cash assumed	(45,943)	(71,288)
Net cash used in investing activities	(46,596)	(69,460)
Cash flows from financing activities:		
Proceeds from exercise of stock options	3,734	678
Income tax benefit for stock option exercises	880	
Repayments under line of credit		(28,954)
Proceeds from long-term debt	30,000	100,000
Repayments of long-term debt	(323)	
Payments of debt issuance costs	(476)	(3,160)
Repayments of capital lease obligations	(28)	(25)
Net cash provided by financing activities	33,787	68,539
Net change in cash and cash equivalents	(12,904)	8,572
Cash and cash equivalents, beginning of period	26,160	3,754
Cash and cash equivalents, end of period	\$ 13,256	\$ 12,326
Supplemental disclosures of cash flow information:		
Cash payments for interest	\$ 1,791	\$ 296
Cash payments for income taxes	\$ 1,915	\$ 41

See accompanying notes

SI International, Inc. and Subsidiaries

Notes to consolidated financial statements

(Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements of SI International, Inc. and its subsidiaries have been prepared in accordance with 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 ended April 1, 2006 are not necessarily indicative of the results that may be expected for the year ending December 30, 2006. 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 31, 2005. 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

Edgar Filing: SI INTERNATIONAL INC - 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. 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.

As a result of this policy, we ended our first quarter on April 1, 2006 to provide us with a 13 week quarter.

Cash and cash equivalents

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

Revenue Recognition

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 quarters ending April 1, 2006 and March 26, 2005.

	Three Months Ended	
	April 1, 2006	March 26, 2005
Department of Defense	48.0%	49.0%
Federal civilian agencies	50.2	48.9
Commercial entities	1.8	2.1
Total revenue	100.0%	100.0%

For the three months ended April 1, 2006 and March 26, 2005, we had one contract that generated more than 10% of our revenue. For the three months ended April 1, 2006 and March 26, 2005, our C4I2TSR contract with the U.S. Air Force Space Command represented approximately 19.3% and 17.9% of our revenue, respectively.

Deferred financing costs

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

	April 1, 2006	December 31, 2005
Deferred loan costs	\$ 5,451	\$ 4,975
Accumulated amortization	(1,736)	(1,542)
	\$ 3,715	\$ 3,433

Intangible assets

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 accumulated amortization of intangible assets is \$3.6 million and \$3.0 million, respectively, as of April 1, 2006 and December 31, 2005. Amortization expense is estimated to be \$3.1 million, \$2.8 million, \$2.5 million, \$2.2 million and \$2.2 million for the years 2006, 2007, 2008, 2009 and 2010, respectively.

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 April 1, 2006 and December 31, 2005.

Stock-based compensation

Effective January 1, 2006, the Company adopted the provisions of SFAS No. 123R using the modified prospective transition method. Due to the use of the modified prospective method, prior interim periods and fiscal years will not reflect any restated amounts. As disclosed in the stock option plans, the Company accelerated the vesting of unvested stock options previously awarded to employees, officers and directors in December 2005. The Company had no unvested stock options on January 1, 2006. The Company issued insignificant stock options in the quarter ended April 1, 2006. Accordingly, no stock compensation expense was recognized during the first quarter.

Edgar Filing: SI INTERNATIONAL INC - Form 10-Q

Prior to the adoption of SFAS No. 123R, the Company accounted for stock-based compensation using the intrinsic value method prescribed in APB Opinion No. 25 and related interpretations. Accordingly, compensation expense for stock options was 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 following table illustrates the effect on net income and earnings per share if the compensation costs for the Company's stock options had been determined based on SFAS No. 123.

	Three Months Ended	
	April 1, 2006	March 26, 2005
Net income - as reported	\$ 4,314	\$ 3,224
Add: total stock-based employee compensation expense as reported under intrinsic value method (APB No. 25) for all awards, net of tax		19
Deduct: Total stock-based compensation expense determined under fair value based method (SFAS No. 123) for all awards, net of tax		(642)
Net income - pro forma	4,314	2,601
Basic earnings per share - as reported	0.38	0.29
Diluted earnings per share - as reported	0.36	0.28
Basic earnings per share - pro forma	0.38	0.24
Diluted earnings per share - pro forma	0.36	0.22

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 April 1, 2006 and March 26, 2005:

	Fiscal Year	
	April 1, 2006	Mar. 26, 2005
Risk-free interest rate	4.72%	4.00%
Expected life of options	5 years	7 years
Expected stock price volatility	44%	50%
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.

As of April 1, 2006, the total remaining unrecognized compensation expense related to unvested options was \$0.2 million which will be recognized over the weighted average period of 4 years.

Prior to the adoption of SFAS No. 123R, the Company presented all tax benefits related to the exercise of stock options as operating cash flows in the consolidated statement of cash flows. SFAS No. 123R requires the cash flows resulting from the tax benefits generated from tax

Edgar Filing: SI INTERNATIONAL INC - Form 10-Q

deductions in excess of the compensation costs recognized for those options to be classified as financing cash flows.

8

—