

SRA INTERNATIONAL INC

Form 10-K

August 16, 2007

[Table of Contents](#)

---

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

---

**FORM 10-K**

---

(Mark One)

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

**FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

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

Commission File Number 001-31334

---

**SRA International, Inc.**

(Exact name of Registrant as Specified in its Charter)

---

**Delaware**  
(State or Other Jurisdiction of

Incorporation or Organization)

**4300 Fair Lakes Court, Fairfax, Virginia**  
(Address of Principal Executive Offices)

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

---

**54-1360804**  
(I.R.S. Employer

Identification No.)

**22033**  
(Zip Code)

# Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

## Securities registered pursuant to Section 12(b) of the Act:

Title of Class	Name of Exchange on Which Registered
Class A common stock, \$0.004 par value per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

---

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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, and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

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 ☒

The aggregate market value of common stock held by non-affiliates of the registrant as of December 31, 2006, based upon the closing price of SRA International, Inc. class A common stock on the New York Stock Exchange on December 29, 2006, was \$1,103,408,730.

As of August 10, 2007, there were 43,024,386 shares outstanding of the registrant's class A common stock and 14,199,828 shares outstanding of class B common stock.

## DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the definitive proxy statement to be used in connection with the SRA International, Inc. annual meeting of stockholders, to be held on October 23, 2007, and to be mailed to stockholders of record as of September 10, 2007, are incorporated by reference into Part III of this Form 10-K.

---

**Table of Contents**

**SRA INTERNATIONAL, INC.**

**FORM 10-K**

**TABLE OF CONTENTS**

	<b>Page</b>
<b><u>Part I</u></b>	
Item 1. <u>Business</u>	1
Item 1A. <u>Risk Factors</u>	16
Item 1B. <u>Unresolved Staff Comments</u>	28
Item 2. <u>Properties</u>	28
Item 3. <u>Legal Proceedings</u>	28
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	28
<b><u>Part II</u></b>	
Item 5. <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	29
Item 6. <u>Selected Financial Data</u>	31
Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	32
Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	44
Item 8. <u>Financial Statements and Supplementary Data</u>	45
Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	45
Item 9A. <u>Controls and Procedures</u>	45
Item 9B. <u>Other Information</u>	48
<b><u>Part III</u></b>	
Item 10. <u>Directors, Executive Officers and Corporate Governance</u>	49
Item 11. <u>Executive Compensation</u>	49
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	49
Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>	49
Item 14. <u>Principal Accountant Fees and Services</u>	49
<b><u>Part IV</u></b>	
Item 15. <u>Exhibits and Financial Statement Schedules</u>	50
<u>Signatures</u>	52

---

**Table of Contents**

**PART I**

**Forward-Looking Statements**

Some of the statements under Business, Management's Discussion and Analysis of Financial Condition and Results of Operations, and elsewhere in this Form 10-K constitute forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995. These statements involve known and unknown risks, uncertainties, and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. In some cases, you can identify these statements by forward-looking words such as anticipate, believe, could, estimate, expect, intend, may, plan, potential, should, will, and would or similar words. You should read statements that contain forward-looking information carefully because they discuss our future expectations, contain projections of our future results of operations or of our financial position, or state other forward-looking information. We believe that it is important to communicate our future expectations to our investors. However, there may be events in the future that we are not able to predict or control accurately. The factors listed in the section captioned Risk Factors, as well as any cautionary language in this Form 10-K, provide examples of risks, uncertainties, and events that may cause our actual results to differ materially from the expectations we describe in our forward-looking statements.

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

**Item 1. BUSINESS**

**OVERVIEW**

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

We have provided technology and strategic consulting services and solutions to federal government clients for over 29 years and have longstanding relationships with many of them. We have served clients within the Departments of the Army, Navy, and Air Force, the Joint Chiefs of Staff, the Office of the Secretary of Defense, the Department of the Treasury, and the Federal Emergency Management Agency for over 25 years. We currently serve approximately 300 government clients on over 900 active engagements. Our business is diversified, with no single client or client group accounting for more than 12% of our revenue during any of the last three fiscal years. For each of the last three fiscal years, we have been the prime contractor on engagements representing over 86% of our total revenue.

Our founder and chairman, Ernst Volgenau, has been with us since our inception. Our 86 officers have an average tenure with our company of approximately 14 years, including any prior service with acquired companies. Our management team is supported by a high quality staff of more than 5,200 people, approximately 97% of whom are professional staff. Our professional staff is highly educated, with approximately one-third possessing advanced degrees. In addition, over two-thirds of our employees hold federal government security clearances.

From fiscal 2002 to fiscal 2007, we increased our revenue at a compound annual growth rate of approximately 28.6%. Our revenue for the fiscal year ended June 30, 2007 was \$1.27 billion, a 7.6% increase over the prior fiscal year. As of June 30, 2007, our backlog was approximately \$3.4 billion, of which \$600.4 million was funded. As of June 30, 2006, our backlog was \$3.3 billion, of which \$512.8 million was funded. In January 2002, we acquired The Marasco Newton Group, Ltd., or MNG, our first government services acquisition. In January 2003, we acquired Adroit Systems, Inc., or Adroit, for its expertise in the areas of command and control, communications, computers, intelligence, surveillance, and reconnaissance, or C4ISR. In January 2004, we acquired ORION Scientific Systems, or Orion, a privately-held company focused on

## **Table of Contents**

counterterrorism and counterintelligence. In April 2005, we acquired Touchstone Consulting Group, Inc., or Touchstone, a privately-held management consultancy with an established track record of serving senior executives in the federal government. In July 2005, we acquired Galaxy Scientific Corporation, or Galaxy, a provider of systems engineering, information technology, and tactical communications services and solutions to the federal government. In November 2005, we acquired Spectrum Solutions Group, Inc., or Spectrum, a privately-held provider of enterprise solutions to clients throughout the federal government. In April 2006, we acquired Mercomms Unlimited, Inc., or Mercomms, which specializes in advanced maritime and defense communications technologies for the federal government. In October 2006, we acquired RABA Technologies, LLC, or RABA, a provider of high-end technical services to the national security and intelligence communities. Subsequent to fiscal 2007, in August 2007, we acquired Constella Group, LLC, or Constella, a provider of global health consulting services. We expect these acquisitions will enable us to sell a more comprehensive set of services and solutions to a larger client base and to jointly pursue potential new opportunities.

## **INDUSTRY BACKGROUND**

The federal government is the largest consumer of information technology services and solutions in the United States. We believe that the federal government's spending on information technology will continue to increase in the next several years, driven by the expansion of national defense and homeland security programs, increased reliance on information technology outsourcing, demand for greater government efficiency and effectiveness, and the continuing impact of federal procurement reform. According to the *Federal IT Market Forecast, FY 2007 - FY 2012* report published by INPUT, an independent federal government market research firm, the contracted portion of federal government spending on information technology is forecasted to grow at an annual rate of 5.6% from \$65.2 billion in federal fiscal year 2007 to \$85.6 billion in federal fiscal year 2012.

*Increased Spending on National Defense and Homeland Security.* The terrorist attacks of September 11, 2001, the war in Iraq, and other recent international events have intensified the federal government's commitment to strengthen our country's military, intelligence, and homeland security capabilities and increased the need for information technology capable of supporting these functions. We believe intelligence agencies will increase demand for data and text mining solutions to enable them to extract, analyze, and present data gathered from the massive volumes of information available through open sources such as the Internet. This increased focus on national security, homeland security, and intelligence has also reinforced the need for interoperability among the many disparate information technology systems throughout the federal government. We believe the Department of Homeland Security, or DHS, and the intelligence agencies are increasingly interested in enterprise systems that enable better coordination and communication within and among agencies and departments.

*Increased Reliance on Information Technology Outsourcing.* Outsourcing of information technology operations is becoming an increasingly attractive alternative for federal agencies that are striving to maintain their core functions with limited technical resources and a shrinking information technology workforce, while at the same time upgrading technology and standardizing and streamlining operations. We expect reductions in the federal information technology workforce to continue due to, among other factors, a projected increase in the number of retiring government employees.

*Demand for Greater Government Efficiency and Effectiveness.* Budget-constrained federal government agencies are under increasing pressure to cut costs, while at the same time continuing to improve and upgrade their technological capabilities. We believe government chief information officers will increasingly pursue initiatives such as adopting an enterprise architecture and requiring a business justification for program approvals. We believe new services, including web and wireless services, will be particularly important as government agencies respond to the necessity for interoperability among the information technology systems throughout the government and the demand for comprehensive electronic services to the public.

*Continuing Impact of Federal Procurement Reform.* Over the past decade, federal government agencies have adopted procurement processes that are more similar to typical commercial contract acquisition practices. Changes in the procurement process have streamlined the process of purchasing information technology services by reducing procurement time and acquisition costs. These changes provide increased flexibility and enable government entities to award contracts based on factors other than price alone, such as successful past performance and distinguishing corporate and technical capabilities.

There are currently two widely used contract methods in federal procurement, single award/defined statement of work contracts and indefinite delivery/indefinite quantity contracts:

*Single award/defined statement of work contracts.* Under this contract method, which can take a year or more to complete, an agency solicits, qualifies, and then requests proposals from interested contractors. The agency then evaluates the bids and typically awards

the contract to a single contractor for a specified service. Historically,

---

## **Table of Contents**

single award/defined statement of work contracts were the most prevalent type of contract award used by federal government clients; however, the use of this type of contract has been declining for the past several years.

*Indefinite delivery/indefinite quantity contracts.* Under this contract method, a federal government agency can form preferred provider relationships with one or more contractors. This category includes agency-specific indefinite delivery/indefinite quantity, or ID/IQ, contracts; blanket purchase agreements, or BPAs; government-wide acquisition contracts, or GWACs; and General Services Administration, or GSA, schedule contracts. These umbrella contracts outline the basic terms and conditions under which federal government agencies may order services. ID/IQ contracts are typically managed by one agency, the sponsoring agency, and may be either for the use of a specific agency or available for use by any agency of the federal government. ID/IQ contracts available for use by any agency of the federal government are commonly referred to as GWACs. Contractors within the industry compete to be pre-selected to perform work under an ID/IQ contract. An ordering agency then issues delivery orders for services to be performed under the contract. If the ID/IQ contract has a single prime contractor, only that contractor may be awarded delivery orders. If the contract has multiple prime contractors, the award of each delivery order typically will be competitively determined among the pre-selected contractors.

GSA schedules are listings of services and products, along with their respective prices, offered by federal government contractors. The schedules are maintained by the GSA for use by any federal agency or other authorized entity, including state and local governments. In order for a contractor to enter into a contract with the GSA and be listed on a GSA schedule, the contractor must be pre-qualified and selected by the GSA. When an agency selects services under a GSA schedule contract, the user agency, or the GSA on its behalf, will typically conduct a competitive process, limited to qualified GSA schedule contractors.

Due to the lower contract procurement costs, reduced procurement time, and increased flexibility associated with ID/IQ contracts, BPAs, GWACs and GSA schedule contracts, these vehicles have been utilized frequently in the last several years.

*Market Opportunity.* The federal government's demand for information technology services has increased, and is expected to continue to increase, as a result of planned increases in spending for national defense and homeland security; increased reliance on outsourced information technology programs; demand for greater government efficiency and effectiveness; and the continuing impact of federal procurement reform. We believe that for information technology providers to win contract awards from the federal government they must possess strong and stable management, highly skilled personnel, a deep knowledge of the government's business processes, demonstrated technological expertise, a strong record of past performance, and key positioning on multiple award contract vehicles such as GSA schedule contracts, GWACs and agency-specific ID/IQ contracts.

## **OUR APPROACH**

We are a high-end technology and strategic consulting services and solutions provider focused on delivering results that create tangible value for our clients. We maintain the comprehensive information technology skills required to support the entire life-cycle of our clients' systems, from strategic planning to operational support. We employ interdisciplinary teams to staff our engagements, which enables us to deliver services and solutions that combine our comprehensive knowledge of our clients' business processes with the necessary technical expertise. Depending on client needs, we may integrate commercially available products with existing systems or develop a comprehensive solution that involves designing, integrating, maintaining, and upgrading a custom-built system.

To maximize our ability to deliver consistent results that successfully meet client needs, we have developed a proprietary project management and technical execution methodology, which we call ELITE. We train our project managers and technical leaders on this methodology, which emphasizes using mature, repeatable processes that reduce risk and maximize successful project completion. As a result, our company, including all its sectors and business units, has received a Capability Maturity Model Integrated, or CMMI, level 3 rating under the standards established by the Software Engineering Institute. This rating reflects that we have mature, repeatable processes that we believe help reduce risk, improve technical delivery, improve product quality, contain costs, and meet demanding schedules. Often the federal government requires a CMMI level 3 rating as a qualification to bid on complex software development and systems integration projects.

We believe we are able to execute our approach successfully as a result of five core strengths:

### ***Strong, Stable Management and Highly Skilled Personnel***

Our 86 officers have an average tenure with our company of approximately 14 years, including any prior service with acquired companies, providing extensive industry experience and strong continuity of management. Several members of our





## **Table of Contents**

management team are former senior military officers or government officials who have deep knowledge of the federal government and its information technology needs. Our corporate culture fosters teamwork and excellence, which has contributed to our being named in 2007 by *Fortune* magazine as one of the 100 Best Companies to Work For for the eighth straight year. This, in turn, has enhanced our ability to recruit and retain highly skilled personnel. Our professional staff is highly educated, with approximately one-third holding advanced degrees.

### ***Knowledge of Government Clients' Business Processes***

We have served clients within the Departments of the Army, Navy, and Air Force, the Joint Chiefs of Staff, the Office of the Secretary of Defense, the Department of the Treasury, and the Federal Emergency Management Agency for over 25 years. As a result of these longstanding relationships, we have an in-depth knowledge of our clients' business processes, which enables us to design solutions that address their strategic goals and integrate with their existing systems. We have also recruited strategic hires with significant governmental or technical experience who have added to our knowledge of our clients' business processes and who have extended our expertise into new areas.

### ***Technical Expertise***

We invest in research and development in areas such as data mining, natural language understanding, knowledge management, information assurance, and wireless applications in order to offer clients the most up-to-date technological solutions. We continue to use our domain expertise and advanced technical knowledge to anticipate, identify, and develop forward-looking technologies to enable clients to meet their mission objectives. We use our proprietary intellectual property, including our ELITE life-cycle methodology, to provide value-added solutions for our clients.

### ***Proven Record of Past Performance***

We have provided technology and strategic consulting services and solutions to the federal government for over 29 years and have longstanding relationships with many of our clients. In order to promote high quality results and client satisfaction, we emphasize long-term assignment of required staff and consistently review our project performance, including regularly surveying our customers regarding their perceptions of our performance. On competitively awarded engagements on which we were the incumbent, we have a renewal rate of at least 90% for each of the last three fiscal years. We calculate our contract renewal rate based on the number of engagements that come up for recompetition during the period and the number of those recompetitions that we win.

### ***Key Positioning as a Prime Contractor***

We are currently a prime contractor on three of the federal government's four largest information technology services GWACs: Millennia, Millennia Lite, and CIO-SP2i. SRA was also recently awarded a prime contract under GSA's newest GWAC, Alliant. We hold six GSA schedule contracts and we are a prime contractor on more than 35 agency-specific ID/IQ contracts. This broad contract portfolio gives us extensive reach as a preferred provider and enables us to deliver the full range of our services and solutions to any organization in the federal government. Serving as a prime contractor positions us to achieve better client relationships, to exert more control and influence over quality results, to have clearer visibility into future opportunities, and to earn enhanced profit margins.

## **GROWTH STRATEGY**

Our objective is to continue to profitably grow our business as a leading provider of technology and strategic consulting services and solutions to a wide variety of federal government organizations. Our growth strategy includes the following.

### ***Leverage Our Longstanding Client Relationships to Cross-Sell Our Full Range of Services***

We plan to continue expanding the scope of the services we provide to our existing clients. We are adept at penetrating, cross-selling to, and building-out existing client accounts through our successful performance and comprehensive knowledge of their business, which has led to many long-term contract relationships. We believe our high level of client satisfaction and deep knowledge of our clients' business processes enhance our ability to cross-sell additional services.

### ***Expand Our Client Base***

We believe that the federal government's increasing reliance on outsourcing and the increased emphasis on national security and homeland security, coupled with the changes in procurement reform, have significantly increased our market opportunity. We have a longstanding heritage

## Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

of supporting the federal government in the areas of contingency and disaster response planning; information assurance; critical infrastructure protection; and command and control, communications, and

## **Table of Contents**

intelligence. We intend to leverage this broad experience to expand our client base to include organizations in the federal government for which we have not historically worked. We believe our ability to win new clients is enhanced by our position as a prime contractor on three of the four largest information technology services GWACs. These contracts enable us to sell our services and solutions to virtually any federal government agency. In addition, we intend to continue strategic hiring to expand the breadth of our expertise into new areas of the federal government or new technologies. We have used strategic hires as a cost-effective way to build-out client accounts, to establish new competencies, and to penetrate new markets.

### ***Focus Our Applied Research and Development Investments to Enhance Our Core Business***

We intend to continue to invest in applied research and development initiatives to enhance our competitive position within our business. For example, we have employed proprietary intellectual property developed through these initiatives in engagements relating to hyperspectral imagery, a virtual operations center, a sensor network analytical platform, visual radio frequency identification analyzer, foreign language text analysis, and information extraction systems which can automatically adapt to new extraction requirements.

### ***Pursue Strategic Acquisitions***

We plan to continue to pursue strategic acquisitions to complement internal growth and to position ourselves to capitalize on anticipated high growth areas. For example, we acquired MNG in January 2002, Adroit in January 2003, Orion in January 2004, Touchstone in April 2005, Galaxy in July 2005, Spectrum in November 2005, Mercomms in April 2006, RABA in October 2006, and Constella in August 2007. Our acquisition strategy is focused on firms that will enable us to cost-effectively add new clients, specific agency knowledge, or technical expertise. We intend to continue to selectively acquire high quality companies that accelerate our access to existing or new markets that we believe have strong growth dynamics.

## **OUR SERVICES AND BUSINESS SOLUTIONS**

### ***Our Services***

We offer a broad range of technology and strategic consulting services that spans the information technology life cycle, including: strategic consulting; systems design, development, and integration; and outsourcing and managed services.

*Strategic Consulting.* We help clients formulate business and execution plans to improve performance, cost effectiveness, and quality of service. We assess current operations, develop targeted strategies and plans for improvement, define key priorities and accountabilities, and design enterprise architectures that capitalize on client investments in legacy systems while enabling them to make a seamless transition to modern technology environments. We work with leaders and their management teams to develop specific implementation plans that achieve the established strategies, effectively track and manage implementation efforts, and measure and validate results.

*Systems Design, Development, and Integration.* Our services include project management, systems design, network and systems integration, data analysis and integration, security engineering, software development, database design and development, and independent test and evaluation. We analyze system concepts and assess data and information needs, define requirements, develop operational prototypes, and integrate complex mission-critical systems and solutions that comply with a client's enterprise architecture. Based on client requirements, we may design custom-built systems; integrate and implement commercial off-the-shelf solutions, such as those for supply chain management, enterprise resource planning, and case management; or combine both approaches using service-oriented architecture principles and other industry best practices.

*Outsourcing and Managed Services.* We partner with clients to consolidate and modernize existing infrastructures, improve customer service, and reduce the total cost of operations through effective use of industry best practices and performance-based contracting methods. We also support clients with operations management services, sometimes referred to as co-sourcing. Based on client needs, we may oversee their technical infrastructure, manage their applications and networks, or operate their entire business processes in accordance with service-level agreements.

### ***Our Business Solutions***

We have developed business solutions that focus on specific business requirements that are common to many of our clients. These business solutions generally apply to clients within each of our target markets. Our core business solutions include business intelligence: text and data mining; contingency and disaster planning; enterprise architecture and portfolio management; enterprise resource planning; identity management; information assurance and privacy protection; information sharing and knowledge management; outsourcing, managed services,

## Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

and infrastructure modernization; service-oriented architecture; training, modeling, and simulation; and wireless integration services. These business solutions consist of

## **Table of Contents**

repeatable tools, techniques, and methods that reflect the specific competencies we have gained from significant experience in these areas. Our current business solutions are enhanced through our focus on applied research and development in the areas of data mining, natural language understanding, knowledge management, and wireless applications.

*Business Intelligence: Text and Data Mining.* We provide data mining solutions to help clients analyze and identify hidden patterns in large databases, data marts and warehouses, spreadsheets, and text. This gives them foresight into future trends, as well as the ability to predict outcomes and classify transactions.

We combine the capabilities of our NetOwl® text mining software and our ORIONMagic® knowledge management software to offer our clients enhanced means of managing, exploiting, and analyzing large amounts of enterprise data. ORIONMagic helps clients cull through gigabytes of information, store the most relevant pieces, and analytically scour each piece. Our text mining tools collect, search, organize, analyze and turn large amounts of unstructured text data into structured data for greater utilization. NetOwl software applies advanced natural language understanding technologies to English, Arabic, Chinese, Farsi, French, Korean, and Spanish text to extract content.

In fiscal 2007, we developed and applied new predictive models for the Internal Revenue Service, or IRS, to detect refund fraud at lower cost than previous statistics-based solutions and to detect noncompliance in tax-exempt entity filings. We are also developing a suite of predictive models to detect earned income tax credit noncompliance. For the Environmental Protection Agency, or EPA, we are developing data warehousing and reporting solutions for the ENERGY STAR program.

*Contingency and Disaster Planning.* We offer a broad spectrum of solutions to help clients prepare for, respond to, and recover from events that could adversely affect operations. Our services include continuity of operations and government, disaster response and recovery, crisis communications, and critical infrastructure planning. We have over 25 years' experience supporting clients in these areas across federal, state, and local government. For example, we support the Transportation Security Administration, or TSA, with technical services for a comprehensive TSA-wide continuity of operations program. We provide technical and support services for program, policy, and document development; planning support; tests, training and exercises; and technical assistance and review as well as operations and support services at various facilities. For the Department of Homeland Security's, or DHS's, Office of Infrastructure Protection, or OIP, we provide strategic consulting and operations support, including support to critical infrastructure councils, such as the Sector Partnership Framework and the National Infrastructure Advisory Council. We also support DHS in preparing the private sector for a possible pandemic influenza outbreak. We developed the initial pandemic strategy for OIP and constructed a pandemic preparedness guide for the private sector. We are currently supporting DHS in the implementation of a pandemic guide.

Our work for the Virginia Governor's Office of Commonwealth Preparedness is helping the state's public safety community effectively communicate during daily operations and major emergencies. Our practitioner-driven process for planning and implementation makes use of expertise throughout the state to improve standard operating procedures, technology, and training and exercises for interoperable communications.

In 2006, we received a contract to continue to provide strategy and execution support services to DHS's Office for Interoperability and Compatibility. We deliver program management support; communications and outreach; governance and stakeholder coordination; development of near- and long-term strategies to improve interoperability and incident response; method and tool development; and standards and requirements development and acceleration. Recent accomplishments include the successful roll-out of incident management tools to all major U.S. Navy facilities and statewide strategic planning pilots in three states.

*Enterprise Architecture and Portfolio Management.* Federal agencies use information technology, or IT, investment and governance processes such as enterprise architecture—a framework or blueprint to identify and link processes, systems, databases, and technology to outcomes—and portfolio management to help them make informed investment decisions and to best manage their portfolios of IT projects and programs with reduced risk and cost.

We offer enterprise architecture solutions that combine best practices with our results-based, holistic enterprise architecture approach that delivers measurable progress in both added value and organizational maturity. We have led numerous federal and state government enterprise architecture efforts, turning data into actionable information using a robust set of data and process visualization, governance, analysis, and reporting tools. Our experience includes expertise in implementing and executing enterprise architecture guidance from the Office of Management and Budget, or OMB, the Federal Chief Information Officer, or CIO, Council, and the Government Accountability Office, or GAO.



---

## **Table of Contents**

We have gained extensive enterprise architecture and portfolio management experience during ongoing work with clients including NIH, IRS, EPA, GAO, the Department of Defense, or DoD Missile Defense Agency, the U.S. Marine Corps, and the Department of Justice.

We support NIH's Office of Research Services in planning for and responding to a possible pandemic flu. This year we expanded the enterprise architecture model to aid executives and senior managers in responding to a pandemic involving an extreme loss of personnel. The architecture enhances management planning by providing a high-level view of the enterprise to aid managers who may be quickly put into new positions during a pandemic. It supports cross-organizational analysis by identifying essential functions and resources available through management dashboards. We also facilitated the development of an enterprise-wide pandemic plan.

*Enterprise Resource Planning.* We use enterprise solutions, such as Oracle, PeopleSoft, SAP, and Seibel applications and technologies, to help our federal government clients improve performance by modernizing, consolidating, and unifying their financial, human resource, supply chain, and customer relationship management systems.

Clients for whom we provide these services include the U.S. Coast Guard, for whom we designed and implemented a service-wide human resources enterprise resource planning system, the Department of Agriculture, and the Pension Benefit Guaranty Corporation.

The Department of Agriculture, or USDA relies on a large network of suppliers, warehouses, distribution centers, and transportation channels to distribute commodities to over 30 million Americans and 280 million people abroad. This includes school lunch programs for children across the U.S. We designed and maintained a Web-based supply chain management which enables USDA to manage the many components of this supply chain more effectively. This performance-based contract, worth an estimated \$90.5 million over five years if all options are exercised, represents our largest enterprise resource planning implementation to date. When fully operational, the system will feature commercial off-the-shelf products and software and help improve USDA's ability to view the status of their food commodity requests at any stage of the order and fulfillment cycle, with improved demand and supply planning, an enhanced procurement process, reduction in order cycle times, timely and more accurate financial processing, and other customer relationship management areas to reduce costs for both USDA and its customers.

*Identity Management.* Homeland Security Presidential Directive-12 set policy for a secure, reliable, and common identification standard for federal employees and contractors. We are a founding member of the Federation for Identity and Cross-Credentialing Systems consortium, and are helping to provide the government with the necessary security and standardization to meet this directive. The consortium is currently working with the DoD to provide trusted, interoperable identity verification and credential authentication for contractors accessing secure government facilities and networks.

We combine our experience in providing public key-enabled applications, smart card technology, and directory technologies with processes, techniques, and methodologies to address the privacy, security, technology, and program and change management issues facing our clients. These clients include the Departments of Health and Human Services, Justice, and Homeland Security; the EPA; and the Federal Deposit Insurance Corporation, or FDIC.

*Information Assurance and Privacy Solutions.* Our information assurance and privacy solutions enable our clients to achieve regulatory compliance, ensure business continuity, limit liability, and enhance privacy risk mitigation. Our experience in the federal government includes security planning and engineering, threat and vulnerability analysis, penetration testing, computer forensic analysis, education and training, intrusion detection and response system support, systems certification and accreditation, and privacy impact assessments.

We deliver a wide range of information assurance and privacy protection services to clients across government, including the Departments of Agriculture, Defense, Education, Health and Human Services, Homeland Security, Justice, Labor, and the Treasury; EPA; FDIC; the Office of Personnel Management, or OPM; the Securities and Exchange Commission; and the U.S. Agency for International Development, or USAID.

*Information Sharing and Knowledge Management.* We provide strategic advice on information sharing and we use our text and data mining, privacy, security, and identity management expertise to design solutions to meet clients' needs for secure, efficient information sharing. We help our clients meet homeland security mandates and exploit the potential of the Internet for real-time analysis and decision-making.

## **Table of Contents**

Our knowledge management services and solutions help agencies effectively access, capture, retrieve, manage, use, and share enterprise information to maximize communication and productivity. We integrate commercial-off-the-shelf and custom applications to increase organizational knowledge flow and perform knowledge audits, portal design and configuration, usability analysis, taxonomy and metadata services, and enterprise information management governance and architectures, including access, content, document, and records management to enhance information sharing across systems and organizations. We provide these services for clients in the federal government, including the U.S. Air Force.

*Outsourcing, Managed Services, and Infrastructure Modernization.* We provide outsourcing and managed services solutions to help clients consolidate and modernize their infrastructures while preserving inherent value, improving customer service, and reducing the cost of operations using industry best practices, repeatable processes, and performance-based contracting methods. We support clients with operations management services and we may oversee their technical infrastructures, manage their applications and networks, or operate their entire business processes in accordance with service-level agreements. Clients we provide these services for include the Health Resources and Services Administration, the National Guard Bureau, FDIC, GAO, OPM, and USAID.

We deliver infrastructure management solutions, including IT service management consulting and enterprise systems management, to support our clients' evolving business needs and missions. We help them to manage, successfully and cost-effectively, the complexity of geographically dispersed IT infrastructures and obtain increased operational efficiencies by aligning infrastructure and application performance measures with business performance measures.

Our solutions provide delivery of IT Infrastructure Library standards-based processes and the ISO 20000 standard for IT service management. We deliver IT service management consulting, education, and implementation services as part of a delivery methodology, which we integrate with our CMMI Level 3 processes.

*Service-Oriented Architecture.* With constant advances in IT, our clients have an ongoing need for a service-oriented architecture—a disciplined, standards-based framework for building and managing enterprise systems using shared services and infrastructure to increase business agility, reduce redundancy, and enable new modes of interaction. We apply service-oriented architecture processes, patterns, and technologies across the IT life cycle to align our clients' resources with their missions, identify redundant services, capture business processes, and implement governance structures in existing enterprise architectures. We have experience in applying a wide range of service-oriented technologies, tools, and platforms, including Web service standards, service registries, enterprise service bus products, and large-scale integrated service-oriented architecture application suites.

We deliver service-oriented architecture-based solutions to the Departments of Agriculture and Defense; the Library of Congress; and USAID. Many of our ERP implementations are built on service-oriented architecture-based templates, industry best practices, and product roadmaps.

*Training, Modeling, and Simulation.* Our training services and solutions range from custom tools to integration of commercial systems. All are designed to enhance workforce performance at any level. We use our systematic development approach, based on rigorous Instructional System Development standards, to develop curriculum, computer- or Web-based distance learning, and e-learning solutions. We provide full life cycle services for implementing learning management systems and integrating the systems with legacy or commercial off-the-shelf products. Our closed loop system processes connect training to actual job performance and provides a mechanism to monitor, evaluate, and validate that the training achieves the desired outcomes through demonstrable on-the-job performance outcomes. We have designed and implemented training systems for clients across DoD and civil agencies.

*Wireless Integration Services.* Our wireless integration services include full life cycle consulting and security planning, enterprise deployment and integration, and application development. These services enable our clients to cost-effectively expand their infrastructures to the wireless enterprise. This makes information more accessible and offers portability, flexibility, security, and reliability.

Clients for whom we provided wireless integration services in fiscal 2007 include the Navy Exchange Service Command, where we performed an assessment and provided industry best practices for the security of their wireless environment, and the FDIC, where we developed and implemented cost savings methodologies.

## **TARGET MARKETS**

We deliver our technology and strategic consulting services and solutions primarily to federal government clients within three target markets:





## Table of Contents

national security, which consists of two components:

command and control, communications, and intelligence, and

information systems for the Department of Defense;

civil government; and

health care and public health.

We also provide technology and strategic consulting services and solutions to a few commercial clients.

The following is a summary of our business in each of our markets:

Market	Total Revenue		Contract Backlog as of June 30, 2007
	Fiscal year ended June 30, 2007	Fiscal year ended June 30, 2006 (in millions)	
National security	\$ 745.3	\$ 697.2	\$ 1,953.3
Civil government	395.6	374.5	1,030.1
Health care and public health	115.5	100.0	416.6
Commercial	12.5	7.6	10.2
Total	\$ 1,268.9	\$ 1,179.3	\$ 3,410.2

### National Security

We view the national security market as consisting of two distinct components: command and control, communications, and intelligence, and defense information systems.

*Command and Control, Communications, and Intelligence.* The broad range of services we deliver to national security, law enforcement, and intelligence agencies and organizations includes program management; research, systems analysis, and engineering; intelligence, surveillance, and reconnaissance; and counterintelligence and counterterrorism.

Our work on the U.S. Air Force Flexible Access Secure Transfer Technology Evaluation Project will help enhance coalition force interoperability and improve Joint forces situational awareness and communications. The program management, acquisition planning, spectrum management, modeling and simulation, and systems engineering services we provide are designed to enable U.S. and NATO military units to exchange secure, real-time data, voice, and video over the air across hundreds of miles.

The U.S. Army Natick Soldier Research Development and Engineering Center's Future Force Warrior Advanced Technology Demonstration, the research and development foundation for the Ground Soldier System, is enhancing the safety, mobility, and situational awareness capabilities of U.S. soldiers. We play an integral role in this program through our work with the Air Force Research Laboratory Human Effectiveness Directorate and Future Force Warrior engineers and soldiers. For example, the leader system software we are developing condenses a large volume of information into a manageable interface, improving situational awareness for field platoon leaders. We are also integrating existing and emerging technologies, including speech recognition and the Air Force standard XML Cursor on Target, and helping to improve and augment ground operations to include route navigation planning, medical evacuation and remote physiological monitoring, unmanned ground sensor data management, and target prosecution and engagement.

## Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

The hyperspectral and synthetic imagery analysis we provide to the Army Space and Missile Defense Command is contributing to enhanced force protection for coalition forces in combat zones. In addition, our analysts are pioneering new technical analysis capabilities for homeland security, border security, and missile defense.

We perform a wide and expanding range of research and development services for the U.S. intelligence community, including software development and engineering to support prototype implementation, text mining, embedded programming, and analytical support. These solutions support our client in producing new organizational capabilities and providing computer application integrity and system and network protection.

Violent gang-related crimes are a growing trend across the country, and solving them is complicated by gang members' mobility and growing realm of influence. Our GangNet database system is a browser-based investigative,

## **Table of Contents**

analysis, and statistical resource used by law enforcement officials to record and track gang members and their activities. The system includes the individuals' photos, street names, addresses and known associates, along with gang hand signals and images of their tattoos. The system is continuously updated with additional features, such as mapping and facial recognition. GangNet is used by law enforcement officers in 14 states (including cities such as Las Vegas, Los Angeles, and Minneapolis); the Bureau of Alcohol, Tobacco, Firearms, and Explosives; the Department of Homeland Security's Immigration and Customs Enforcement; and the Federal Bureau of Investigation. It is also being used in Canada. Investigators can use the solution's collaboration and information sharing capabilities across jurisdictions.

A Web-based reporting and management system we have developed for a federal law enforcement agency is helping to improve reporting time and data accuracy for criminal investigations. The portal is accessed by thousands of users across the United States to track and report criminal investigations by local and state agencies and features an advanced search capability and data capture mechanism to quickly disseminate information related to criminal activity. We have migrated over 30 years of legacy data into the new system and have developed a Web interface to simplify data entry.

Our AVALON rapid prototyping environment supports custom application development for the intelligence and aerospace communities. Using our experience and capabilities in service-oriented architecture, we have designed and developed a Web-services capability to enable users to access AVALON's analytic capabilities through a Web browser. We continue to enhance this solution through government-funded research and development contracts.

We are conducting research into emerging computing systems and technologies to produce smaller, faster components with greater computing power. We are also building a prototype to ensure secure, user-specific downloads with a newly designed data containment service that protects computer systems and networks from viruses and worms and provides a safe area for users to work.

*Defense Information Systems.* We design, develop, integrate, and implement complex systems in accordance with network-centric and service-oriented enterprise architectures. We have subject matter expertise in logistics, transportation, acquisition, personnel, finance, and installation management.

In fiscal 2007, we were awarded a new contract to help the U.S. Marine Corps develop an integrated digital work environment for acquisition and life cycle systems management functions. The system will provide a secure and easily accessible common work environment for Marine Corps Systems Command personnel to work collaboratively with other internal and external stakeholders using consistent, automated business processes leveraging a fully integrated data environment. We are delivering a commercial off-the-shelf-based solution and providing requirements analysis, data architecture, systems engineering and integration, knowledge management, and training services.

For 20 years, we have supported the U.S. Transportation Command in its mission to deliver transportation, sustainment, and distribution services to the nation's troops. The range of services we currently provide to Directorates across the Command includes joint exercise program management, enterprise architecture and portfolio management, training, critical infrastructure protection, and data management. In fiscal 2007, we expanded our support with new contracts to design and execute tabletop exercises for contingency planning, and to identify geographic information system technologies and best practices for resource management.

In 2003, the Army Communications-Electronics Command selected Galaxy Scientific Corporation, which we acquired in 2005 as a prime contractor on the Rapid Response contract. The information technology services we deliver under this contract help quickly deploy systems to satisfy the nation's security, defense, and business needs. We received over 20 new task order awards in fiscal 2007 to deliver services to support Army programs around the world. For example, the systems analysis and architecture development work we performed has improved network infrastructure capabilities and will help develop a roadmap for future systems development. Our information assurance services support the Army's Communications Security Logistics Activity's supply chain management initiatives.

We have managed and operated the enterprise operations center for GuardNet XXI, the Army National Guard's enterprise network communications structure, since 2001. GuardNet XXI serves as the communication channel for data and video between the Department of the Army and the National Guard Bureau, encompassing 54 states, U.S. territories, the National Capital Region, and the District of Columbia. The network delivers services to support command and control, mobilization, readiness training, and distance learning. In 2006, we were awarded a new performance-based contract to continue support to the enterprise Army National Guard IT environment. We manage several critical enterprise Army National Guard IT services. This includes wide area network services and other enterprise systems such as Microsoft's Active Directory and Exchange Messaging, service desk, and international video operations. We provide network engineering, operations, and security; systems design, integration, implementation, and management; facility operations;



## **Table of Contents**

equipment maintenance; and support for a full time centralized service desk that receives, routes, and resolves IT support requests from users across all of the states and territories. We developed and have begun implementation of IT Infrastructure Library best practices designed to maximize performance targets in the areas of service availability, capacity, and responsiveness to service level objectives.

### ***Civil Government and Health Care and Public Health***

We help clients in civil agencies develop and implement strategies and use advanced technology to enable operational efficiencies and delivery of service-oriented solutions to citizens. Our clients include the Departments of Agriculture, Commerce, Justice, Labor, Transportation, the Treasury, and Veterans Affairs; the Environmental Protection Agency; the Federal Deposit Insurance Corporation; the Government Accountability Office; the Library of Congress; the National Archives and Records Administration; the U.S. Agency for International Development; and the Department of Health and Human Services including such agencies as the National Institutes of Health and the Food and Drug Administration.

As the single systems integrator providing enterprise-wide IT infrastructure management services to the Federal Deposit Insurance Corporation, or FDIC, we support approximately 7,000 users at FDIC headquarters and 94 field offices nationwide. The services we deliver to this client include program management; client and help desk support; data center and local-area network operations; information security operations; systems and telecommunications engineering and integration support; and hardware/software procurement, distribution, and maintenance. During fiscal 2007, we led and supported key reengineering and process improvement initiatives including desktop refresh for users, year-end processing to meet legislative changes, and automated server builds to simplify the infrastructure, improve customer service, and reduce costs.

The comprehensive enterprise management infrastructure services we deliver to the Office of Personnel Management, or OPM, are helping modernize and improve network operations and processes. We are responsible for the design, architecture, and installation of the current infrastructure to ensure it is available, secure, and responsive to users; compliant with Federal requirements; and scalable to meet OPM's current and future program needs. We are currently developing a strategic plan for modernizing the Personnel Investigations Processing System and integrating all systems that support the OPM personnel security program.

Since 2003, we have provided enterprise-wide technology services to help the National Archives and Records Administration, or NARA, increase the performance and reliability of its IT infrastructure aimed at helping this client meet a growing demand for electronic federal records and online services. We manage and maintain a nationwide network that ties together NARA's users and offices, including the nationwide records centers and the Presidential Libraries. In addition to the program management, help desk, and network design, operations, and security services we contribute, we continue to analyze and implement emerging technologies to enhance customer support and upgrade network capabilities. In fiscal 2007, we engineered and implemented a major upgrade to NARA's enterprise-wide directory and communications infrastructure, enhancing service to all NARA sites.

We developed and manage the National Practitioner Data Bank, or NPDB, and the Healthcare Integrity and Protection Data Bank, or HIPDB, on behalf of the U.S. Health Resources and Services Administration. These national flagging systems protect the public by collecting and disclosing adverse actions taken against health care practitioners, providers, and suppliers to authorized health care entities. In fiscal 2007 we were awarded a new contract to continue to operate, maintain, and enhance the data banks. The NPDB, a fee-for-query system, helps to ensure quality health care by providing a national system to verify adverse actions taken against practitioners and also helps to safeguard against high-risk practitioners moving from state to state or job to job without disclosing their past history. The HIPDB, also a fee-for query system, provides information on health care practitioners, providers, and suppliers and related fraud and abuse. The HIPDB serves the public by promoting quality health care and deterring health care fraud and abuse. Our services include software development, systems engineering, operations services, systems administration, testing, and security services.

We have a long history of delivering support to the EPA's Brownfields Program. We provide technical research and analytical support, legislation and policy analysis, program planning, data analysis, communications and outreach, and facilitation and training to help EPA's Office of Brownfields Cleanup and Redevelopment effectively manage the program. We also develop information management solutions to help them manage, report, and communicate activities, accomplishments, and performance measures for the program. Under two new contracts awarded in fiscal 2007, we will continue to provide the Brownfields Program with integrated program implementation and IT solutions.

## Table of Contents

Since 2003, we have provided a range of technical services to support USAID, a federal agency that delivers economic, development, and humanitarian assistance around the world. In fiscal 2007, we continued to work on critical agency initiatives, including modernization of a worldwide procurement system. The Global Acquisition System we developed supports the Web-based procurement process at USAID and features a real-time interface with the agency's financial system, providing senior managers with integrated system reports to aid in decision making. We also worked with the Peace Corps to install satellite communications from 30 offices worldwide to the headquarters office in Washington, DC. We work with USAID's Office of Economic Growth, Agriculture, and Trade to support their use of information and communication technology to help their global missions implement in-country aid programs. For example, we installed a wireless network infrastructure for the Government of Haiti and helped bring phone and Internet access to villages in Vietnam.

## EXISTING CONTRACT PROFILE

*Contract Types.* As of June 30, 2007 we had over 900 active contract engagements, each employing one of three types of price structures: cost-plus-fee, time-and-materials, and fixed-price.

*Cost-plus-fee contracts.* Cost-plus-fee contracts provide for reimbursement of allowable costs and the payment of a fee, which is our profit. Cost-plus-fixed-fee contracts specify the contract fee in dollars. Cost-plus-award-fee contracts may provide for a base fee amount plus an award fee that varies, within specified limits, based upon the client's assessment of our performance as compared to contractual targets for factors such as cost, quality, schedule, and performance.

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

*Fixed-price contracts.* Under a fixed-price contract, we agree to perform the specified work for a pre-determined price. To the extent our actual costs vary from the estimates upon which the price was negotiated, we will generate more or less than the anticipated amount of profit or could incur a loss. Some fixed-price contracts have a performance-based component, pursuant to which we can earn incentive payments or incur financial penalties based on our performance. We generally do not undertake complex, high-risk work under fixed-price terms.

Our historical contract mix, measured as a percentage of total revenue for the periods indicated, is summarized in the table below.

	Year Ended June 30,		
	2007	2006	2005
Cost-plus-fee	43%	45%	46%
Time-and-materials	42	40	34
Fixed-price	15	15	20

*Government Wide Acquisition Contracts and GSA Schedule Contracts.* We are a leading supplier of technology and strategic consulting services and solutions to federal government clients under GWACs and are currently a prime contractor on three of the four largest information technology services GWACs, measured by the aggregate dollar amount of delivery order awards as of June 30, 2007. We also hold six GSA schedule contracts: Schedule 70, MOBIS, Environmental Advisory Services, Professional Engineering Services, Training and Course Development, and Logistics Worldwide. Despite recent reorganization challenges at GSA, GWACs and GSA schedule contracts remain popular contract award methods, offering flexible, cost-effective, and rapid procurement processes.

The following table sets forth our GSA schedule contracts and the GWAC contracts on which we currently act as a prime contractor. The period of performance indicated below includes all option years.

Contract name	Host agency	Period of performance	Contract ceiling value (in billions)
CIO-SP2i	NIH	December 2000 - December 2010	\$ 20.0
Millennia	GSA FAS	April 1999 - April 2009	25.0
Millennia Lite	GSA FAS	June 2000 - June 2010	20.0
Alliant	GSA FAS	August 2007 - August 2017	50.0

# Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

GSA Schedule 70	GSA FAS	May 1997 August 2007	No ceiling
GSA MOBIS	GSA FAS	June 1998 September 2007	No ceiling
GSA EAS	GSA FAS	September 1999 August 2009	No ceiling
GSA PES	GSA FAS	October 2000 October 2010	No ceiling
GSA LOGWORLD	GSA FAS	August 2004 August 2009	No ceiling
GSA Training and Course Development	GSA FAS	December 2006-December 2011	No ceiling



---

## **Table of Contents**

Revenue under our GWAC and GSA schedule contracts accounted for 54% of our total federal government revenue in fiscal year 2007, 59% in fiscal year 2006 and 60% in fiscal year 2005.

We were awarded a prime contract by GSA under the new Alliant contract in 2007. Although GSA's intent is for Alliant to replace the Millennia and ANSWER contracts, task orders on the Millennia contract may be extended for up to five years beyond April 2009, the current end date for its period of performance.

## **BACKLOG**

As of June 30, 2007, our backlog was approximately \$3.4 billion, of which \$600.4 million was funded. As of June 30, 2006, our backlog was \$3.3 billion, of which \$512.8 million was funded. We define backlog to include funded and unfunded orders for services under existing signed contracts, assuming the exercise of all options relating to those contracts, less the amount of revenue we have previously recognized under those contracts. Backlog includes all contract options that have been priced but not yet funded. Backlog also includes the contract value under single award ID/IQ contracts against which we expect future task orders to be issued without competition. Backlog does not take contract ceiling value into consideration under multiple award contracts, nor does it include any estimate of future potential delivery orders that might be awarded under multiple award ID/IQ vehicles, GWACs, or GSA schedule contracts. We define funded backlog to be the portion of backlog for which funding currently is appropriated and obligated to us under a contract or other authorization for payment signed by an authorized purchasing authority.

We currently expect to recognize revenue during fiscal year 2008 from approximately 25% of our total backlog as of June 30, 2007. Our backlog includes orders under contracts that in some cases extend for several years, with the latest expiring at the end of calendar year 2016.

We cannot guarantee that we will recognize any revenue from our backlog. The federal government has the prerogative to cancel any contract or delivery order at any time. Most of our contracts and delivery orders have cancellation terms that would permit us to recover all or a portion of our incurred costs and potential fees in such cases. Backlog varies considerably from time to time as current contracts or delivery orders are executed and new contracts or delivery orders under existing contracts are won. Our estimate of the portion of the backlog as of June 30, 2007 from which we expect to recognize revenue during fiscal year 2008 is likely to be inaccurate because the receipt and timing of any revenue is subject to various contingencies, many of which are beyond our control.

## **SUBCONTRACTORS**

When we act as a prime contractor, as we typically do, we derive revenue primarily through our own direct labor services, but also through the efforts of our subcontractors. As part of the contract bidding process, we may enter into teaming agreements with subcontractors to enhance our ability to bid on large, complex engagements or to more completely address a particular client's requirements. Teaming agreements and subcontracting relationships are useful because they permit us as a prime contractor to compete more effectively on a wider range of projects. In addition, we may engage a subcontractor to perform a discrete task on a project, or a subcontractor may approach us because of our position as a prime contractor. When we are a prime contractor on an engagement, we are ultimately responsible for the overall engagement as well as the performance of our subcontractors. Revenue derived from work performed by subcontractors represented approximately 29%, 30%, and 32% of our revenue for fiscal year 2007, 2006, and 2005, respectively. No single subcontractor performed work that accounted for more than 5% of our revenue during any of the last three fiscal years.

## **APPLIED RESEARCH AND DEVELOPMENT AND INTELLECTUAL PROPERTY**

We are dedicated to giving our clients the innovative solutions they need to meet their most difficult technology challenges, both now and in the future. Our research and development, or R&D, team works with professionals across the company to assess client needs and ensure that our investments focus on meeting them.

For over 25 years, we have pursued internally- and government-funded R&D in such areas as data mining, natural language understanding, knowledge management, information assurance, and wireless applications. We continue to use our domain expertise and advanced technical knowledge to anticipate, identify, and develop forward-looking technologies to enable clients to meet their mission objectives.

**Table of Contents**

We rely upon a combination of nondisclosure and other contractual arrangements and copyright, trademark, patent, and trade secret laws to protect our proprietary rights. We also enter into confidentiality and intellectual property agreements with all of our employees that require them to disclose any inventions created during employment, that convey all rights to inventions to us, and that restrict the distribution of proprietary information.

**CLIENTS**

Our federal government clients typically exercise independent contracting authority, and even offices or divisions within an agency or department may directly, or through a prime contractor, use our services as a separate client so long as that client has independent decision-making and contracting authority within its organization. We consider each office or division within an agency or department, which engages us directly or through a prime contractor, to be a separate client. The National Guard, as a client group, accounted for approximately 10%, and 11% of our revenue in fiscal years 2006, and 2005, respectively. The United States Agency for International Development, as a client, accounted for approximately 10%, and 12% of our revenue in fiscal years 2006, and 2005, respectively. No other client or client group accounted for more than 10% of our revenue in any of the last three fiscal years.

In our fiscal year ended June 30, 2007, federal government clients accounted for 99% of our revenue, with approximately 1% attributable to commercial clients. In our fiscal year ended June 30, 2007, we derived approximately 58% of our revenue from national security clients, approximately 31% from civilian agencies and departments, approximately 9% from health care and public health clients, and approximately 1% from commercial clients. We currently support 14 of the 15 federal departments in the executive branch, all branches of the military services, and the judicial and legislative branches of the federal government.

The following table sets forth some of our current clients for each of our federal government businesses.

**Selected current federal government clients**

<b>National security</b>	<b>Civil government</b>	<b>Health care and public health</b>
Department of Defense:	Department of the Treasury:	Department of Health and Human Services:
Department of the Army	Internal Revenue Service	Office of the Secretary
Department of the Navy	U.S. Mint	National Institutes of Health
Department of the Air Force	Department of Education	Food and Drug Administration
U.S. Army Reserves	Department of Energy	Centers for Disease Control and Prevention
U.S. Marine Corps	Department of Justice	Health Resources and Services Administration
Joint Chiefs of Staff	Department of the Interior	Administration for Children and Families
U.S. Transportation Command	Department of Labor	Centers for Medicare & Medicaid Services
Air Mobility Command	Department of State	Department of Defense:
Military Sealift Command	U.S. Agency for International Development	Assistant Secretary of Defense for Health Affairs
Surface Deployment and Distribution Command	Department of Commerce	Army Medical Command
U.S. Army Forces Command	Department of Veterans Affairs	Office of the Army Surgeon General
Office of the Secretary of Defense	Department of Transportation:	
Defense Manpower Data Center	Federal Aviation Administration	

## Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

Defense Advanced Research Projects Agency	Department of Agriculture
Defense Logistics Agency	U.S. Peace CorpsEnvironmental Protection Agency
Defense Information Systems Agency	Small Business Administration
National Guard Bureau	National Archives and Records Administration
Various intelligence agencies	Library of Congress
Department of Homeland Security	General Services Administration
Defense Threat Reduction Agency	Government Accountability Office
	Administrative Office of the U.S. Courts
	Pension Benefit Guaranty Corporation
	National Science Foundation
	Office of Personnel Management
	Federal Deposit Insurance Corporation
	Securities and Exchange Commission
	Executive Office of the President
	Office of Management and Budget
	US Nuclear Regulatory Commission

### **SALES AND MARKETING**

We have a highly disciplined sales and marketing process that relies upon the business units addressing each of our target markets to further penetrate and build-out their existing accounts and our centralized federal sales and marketing organization to win new competitive procurements. Primary responsibility for selling additional services to existing clients, including client account build-out and capture of follow-on work, rests with our business units. Recognizing the importance of client account management, we assign entrepreneurial managers and executives to oversee our major accounts.

## **Table of Contents**

Primary responsibility for identifying, qualifying, bidding, and winning new competitive procurements, either for new clients or for large strategic new programs within existing clients, rests with our centralized federal sales and marketing organization. We have approximately 70 experienced sales and marketing professionals that perform business development, task order sales, corporate communications, procurement support, pricing, and proposal development. Members of our sales and marketing organization work closely with their counterparts in our business units as we compete to win new business.

## **COMPETITION**

We compete to win single award contracts and multiple award contracts, such as agency-specific indefinite delivery/indefinite quantity, GWACs, and GSA schedule contracts. After we have won a multiple award contract, we then compete for individual delivery orders under the contract. For example, GSA schedule contracts and prime contractor positions on GWACs are typically awarded to multiple contractors. A multiple award contract will list both the providers and the labor categories of products and services that can be performed under the contract. An individual agency that desires to obtain a service typically invites approved providers to compete based on technological expertise, resources, price, or some other basis.

We encounter many of the same competitors in each of our three target markets. These competitors include:

Federal systems integrators such as Booz Allen Hamilton Inc., CACI International Inc., Computer Sciences Corporation, Electronic Data Systems Corporation, ManTech International Corporation, Science Applications International Corporation, and Unisys Corporation;

Divisions of large defense contractors such as General Dynamics Corporation, Lockheed Martin Corporation, Northrop Grumman Corporation, and Raytheon Company;

Consulting firms such as Accenture Ltd, BearingPoint, Inc., and International Business Machines Corporation; and

Other smaller and specialized government information technology contractors.

## **EMPLOYEES AND CORPORATE CULTURE**

Our success as a technology and strategic consulting services and solutions company is highly dependent on our employees. We believe we have been successful in developing a culture that enables our employees to succeed. We emphasize three essential attributes - an ethic of honesty and service, quality work and client satisfaction, and caring about our people. We reinforce these principles regularly in our recruiting process, training programs, proposals, company meetings, and internal communications. Our active recruiting effort is aligned with our strategic business units and relies heavily on employee referrals in addition to a variety of other recruiting methods. Our primary source of our new recruits is employee referrals, which accounted for approximately 51% of our new hires in fiscal 2007. We have found these referrals to be a reliable source of excellent employees. As a result of our continued focus on our employees, in 2007 we were named by *FORTUNE* magazine as one of the 100 Best Companies to Work for for the eighth consecutive year.

As of June 30, 2007, we had over 5,200 employees. Over two-thirds of our employees have federal government security clearances. Approximately 97% of our employees are professionals or managers with technology or domain expertise, and approximately 3% are administrative managers or support specialists. Our professional staff is highly educated, with approximately one-third holding advanced degrees. We have no employees represented by collective bargaining agreements, and we consider our relations with our employees to be good.

## **CORPORATE INFORMATION**

We were incorporated as Systems Research and Applications Corporation in Virginia in 1976 and began operations in 1978. We reincorporated in Delaware as SRA International, Inc. in 1984. We generally contract with the federal government through our wholly-owned subsidiary, Systems Research and Applications Corporation, but we do business as SRA International, Inc.

## **WEBSITE ACCESS TO SEC REPORTS**

## Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

Our Internet website can be found at <http://www.sra.com>. Information contained on our Internet website is not part of this report. Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and the Section 16 filings of our officers, directors, and shareholders beneficially owning 10% or more of our common stock are available on our website, free of charge, as soon as reasonably practicable after such reports are filed with or furnished to the SEC. Alternatively, you may access these reports at the SEC's Internet website: <http://www.sec.gov>.

**Table of Contents****EXECUTIVE OFFICERS OF THE REGISTRANT**

Our executive officers and their ages as of July 31, 2007, are as follows:

<b>Name</b>	<b>Age</b>	<b>Title</b>
Stanton D. Sloane	56	President and chief executive officer
Stephen C. Hughes	50	Chief financial officer and executive vice president operations
Barry S. Landew	48	Executive vice president for strategic development
Ernst Volgenau	73	Chairman of board of directors

**Stanton D. Sloane** joined us in April 2007 as our president and chief executive officer. He became a member of the Board of Directors in August 2007. Previously, Dr. Sloane served as executive vice president for Integrated Systems and Solutions at Lockheed Martin Corporation from 2004 to 2007 and as president for Lockheed Martin Management/Data Systems from 2003 to 2004. He began his career with General Electric Aerospace in 1984 and progressed through engineering, program management, and business development assignments in a variety of General Electric Aerospace and subsequently Lockheed Martin businesses. Dr. Sloane also served as an officer in the United States Navy.

**Stephen C. Hughes** is our chief financial officer and executive vice president operations. He has served as our chief financial officer since March 1996 and became executive vice president in August 2005. From May 1993 to August 2005 he served as senior vice president of finance and accounting. From March 1989 to May 1993, he was our vice president of finance; from April 1986 to March 1989, he served as our comptroller; and from 1984 to 1986, he served as our manager of accounting. Mr. Hughes practiced in the computer audit and tax groups of Coopers and Lybrand, which is now a part of PricewaterhouseCoopers LLP, from 1983 to 1984.

**Barry S. Landew** is our executive vice president for strategic development. He has served as our vice president for corporate development from 1989 through April 1993 and became executive vice president in August 2005. From 1980 to 1989, he served in various positions with us, including software engineer, program manager, and the head of marketing and sales and proposal development.

**Ernst Volgenau** is our founder and has served as our chairman of the Board of Directors since October 2003. He served as the Company's chief executive officer from October 2003 until December 2004. From 1978 to October 2003, he served as the Company's president and as a director. From 1976 to 1978, he served as the director of inspection and enforcement for the U.S. Nuclear Regulatory Commission. Dr. Volgenau retired from active duty with the U.S. Air Force as Colonel in 1976. His military service included positions in the Office of the Secretary of Defense and as director of data automation for the Air Force Logistics Command.

**Item 1A. RISK FACTORS****Risks Related To Our Industry**

***A reduction in the U.S. defense budget or the diversion of funding from IT services and solutions to support the war against terrorism or the reconstruction of Iraq could result in a substantial decrease in our revenue.***

Revenue from contracts with clients in the Department of Defense and the National Guard accounted for 48%, 49%, and 53% of our revenue for the fiscal years ended June 30, 2007, 2006, and 2005, respectively. A decline in overall U.S. military expenditures, or in the portion of those expenditures allocated to information technology services and solutions, could cause a decrease in our revenue and profitability. The reduction in the U.S. defense budget during the early 1990s caused some defense-related government contractors to experience decreased sales, reduced operating margins and, in some cases, net losses. Defense spending levels may not continue at present levels, and future levels of expenditures and authorizations for existing programs may decline, remain constant, or shift to agencies or programs in areas where we do not currently have contracts. A significant decline in defense expenditures, or a shift in expenditures away from agencies or programs that we support, could cause a material decline in our revenue.

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

Revenue from contracts with civil agency clients accounted for 51%, 50%, and 46% of our revenue for the fiscal years ended June 30, 2007, 2006, and 2005, respectively. We expect civil agency clients will continue to represent a substantial portion of our future revenue. A decline in expenditures by civil agencies, or in the portion of those expenditures allocated to



## **Table of Contents**

information technology services and solutions, could cause a material decrease in our revenue and profitability. In particular, a shift of funds away from civil agencies to pay for programs within other agencies, for example the Department of Defense, to reduce federal budget deficits, or to fund tax reductions, could cause a material decline in our revenue. In particular, it is possible that funding for civil agencies may be diverted to support the ongoing war against terrorism, the reconstruction of Iraq, natural disaster recovery, or other international conflicts.

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

We derived 99% of our revenue for all periods presented herein from contracts with federal government agencies. Accordingly, changes in federal government fiscal or spending policies could directly affect our financial performance. Among the factors that could harm our federal government contracting business are:

the curtailment of the federal government's use of technology services firms;

a significant decline in spending by the federal government in general, or by specific departments or agencies in particular;

a reduction in spending or shift of expenditures from existing programs to pay for an international conflict or related reconstruction efforts;

a failure of Congress to pass adequate supplemental appropriations to pay for an international conflict, or to pay for the cost of related reconstruction efforts;

reductions in federal government programs or requirements;

the adoption of new laws or regulations that affect companies that provide services to the federal government;

delays in the payment of our invoices by government payment offices;

new legislation, procurement regulations, or union pressure that cause federal agencies to adopt restrictive procurement practices regarding the use of outside information technology providers;

changes in policy and goals by the government providing set aside funds to small businesses, disadvantaged businesses, and other socio-economic requirements in the allocation of contracts; and

general economic and political conditions.

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

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



## Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

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

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

The Office of Management and Budget, or OMB, supervises spending by federal agencies, including enforcement of the Government Performance Results Act. This Act requires, among other things, that federal agencies make an adequate business justification to support capital planning initiatives, including all information technology investments. The factors considered by the OMB include, among others, whether the proposed information technology investment is expected to achieve an appropriate return on investment, whether related processes are contemporaneously reviewed, whether inter-operability with existing systems and the capacity for these systems to share data across government has been considered,

## **Table of Contents**

and whether existing off-the-shelf products are being utilized to the extent possible. If our clients do not adequately justify proposed information technology investments to the OMB, the OMB may refuse funding for their new or continuing information technology investments, and we may lose revenue as a result.

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

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

terminate existing contracts, with short notice, for convenience, as well as for default;

reduce or modify contracts or subcontracts;

terminate our facility security clearances and thereby prevent us from receiving classified contracts;

cancel multi-year contracts and related orders if funds for contract performance for any subsequent year become unavailable;

decline to exercise an option to renew a multi-year contract;

claim rights in products, systems, and technology produced by us;

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

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

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

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

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

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

## Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

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

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

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

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

---

## **Table of Contents**

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

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

compliance with antitrust laws.

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

### **Risks Related To Our Business**

***We depend on contracts with U.S. federal government agencies for substantially all of our revenue, and if our relationships with these agencies were harmed, our business would be threatened.***

Revenue from contracts with U.S. federal government agencies accounted for 99% of our revenue for all periods presented herein. Revenue from contracts with clients in the Department of Defense and the National Guard accounted for 48%, 49%, and 53%, of our revenue for the fiscal years ended June 30, 2007, 2006, and 2005, respectively. For this reason, any issue that compromises our relationship with agencies of the federal government in general, or within the Department of Defense and the National Guard in particular, would cause serious harm to our business.

Among the key factors in maintaining our relationships with federal government agencies and departments are our performance on individual contracts and delivery orders, the strength of our professional reputation, and the relationships of our senior management with client personnel. The loss of any member of our senior management could impair our ability to identify and secure new contracts and to maintain good client relations. Additionally, to the extent that our performance does not meet client expectations, or our reputation with one or more key clients is impaired, our revenue and operating results could be materially harmed.

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

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

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

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

the need to bid on engagements in advance of knowing the complete design or full requirements, which may result in unforeseen difficulties in executing the engagement and cost overruns;

---

**Table of Contents**

the substantial cost and managerial time and effort that we spend to prepare bids and proposals for contracts that may not be awarded to us;

the need to accurately estimate the resources and costs that will be required to service any contract we are awarded;

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

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

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

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

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

We believe that one of the key elements of our success is our position as the holder of six GSA schedule contracts and as a prime contractor under three GWACs and more than 35 agency-specific indefinite delivery/indefinite quantity, or ID/IQ, contracts. For the fiscal years ended June 30, 2007, 2006, and 2005, revenue from GSA schedule contracts, GWACs, and other ID/IQ contracts accounted for approximately 77%, 76%, and 77%, respectively, of our revenue from federal government clients. If we were to lose our position on one or more of these contracts, we could lose revenue and our operating results could suffer.

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

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

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

For each of the past several years we have received substantial revenue from government clients relating to work performed by other information technology providers acting as subcontractors to us. In some cases, companies that have not held GSA schedule contracts or secured positions as prime contractors on GWACs have approached us in our capacity as a prime contractor, seeking to perform services as our subcontractor for a government client. Some of these providers that are currently acting as subcontractors to us may in the future secure positions as prime contractors. If one or more of our current subcontractors are awarded prime contractor status in the future, it could reduce or eliminate our revenue for the work they were performing as subcontractors to us. Revenue derived from work performed by our subcontractors represented approximately 29%, 30%, and 32% of our revenue for the fiscal years ended June 30, 2007, 2006, and 2005, respectively.

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

## Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

As a prime contractor, we often rely significantly upon other companies as subcontractors to perform work we are obligated to deliver to our clients. Revenue derived from work performed by our subcontractors represented approximately

## **Table of Contents**

29%, 30%, and 32% of our revenue for the fiscal years ended June 30, 2007, 2006, and 2005, respectively. A failure by one or more of our subcontractors to satisfactorily perform the agreed-upon services on a timely basis may compromise our ability to perform our obligations as a prime contractor. In some cases, we have limited involvement in the work performed by the subcontractor and may have exposure as a result of problems caused by the subcontractor. In extreme cases, performance deficiencies on the part of our subcontractors could result in a government client terminating our contract for default. A default termination could expose us to liability for the agency's costs of re-procurement, damage our reputation, and hurt our ability to compete for future contracts. Additionally, we may have disputes with our subcontractors that could impair our ability to execute our contracts as required.

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

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

fluctuations in revenue earned on contracts;

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

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

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

additions and departures of key personnel;

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

timing of significant bid and proposal costs;

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

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

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

interruption by events beyond our control such as earthquakes, power losses, telecommunications failures, hurricanes, and incidents of terrorism; and



the seasonality of our business.

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

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

We must hire significant numbers of highly qualified individuals who have advanced information technology and technical services skills and who work well with our clients in a government environment. In some cases, they are required to have security clearances issued by the Department of Defense or other government agencies. These employees are in great demand and are likely to remain a limited resource for the foreseeable future. If we are unable to recruit and retain a sufficient number of these employees, our ability to staff recently awarded engagements and to maintain and grow our

## **Table of Contents**

business could be limited. We are operating in a tight labor market and, if it continues to tighten, we could be required to engage larger numbers of subcontractor personnel, which could cause our profit margins to suffer. In addition, some of our contracts contain provisions requiring us to commit to staff an engagement with personnel the client considers key to our successful performance under the contract. In the event we are unable to provide these key personnel or acceptable substitutions, the client may terminate the contract, and we may not be able to recover our costs.

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

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

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

We provide services to the federal government under three types of contracts: cost-plus-fee, time-and-materials, and fixed-price. For the fiscal year ended June 30, 2007, we derived 43%, 42%, and 15% of our revenue from cost-plus-fee, time-and-materials, and fixed-price contracts, respectively. Each of these types of contracts, to differing degrees, involves the risk that we could underestimate our cost of fulfilling the contract, which may reduce the profit we earn or lead to a financial loss on the contract.

Under cost-plus-fee contracts, which are subject to a ceiling amount, we are reimbursed for allowable costs and paid a fee, which may be fixed or performance-based. However, if our costs exceed the ceiling or are not allowable under the terms of the contract or applicable regulations, we may not be able to recover those costs.

Under time-and-materials contracts, we are reimbursed for labor at negotiated hourly billing rates along with the cost of certain expenses, and we assume the risk that our costs of performance may exceed the negotiated hourly rates.

Under fixed-price contracts, we perform specific tasks for a fixed price. Compared to cost-plus-fee contracts and time-and-materials contracts, fixed-price contracts involve greater financial risk due to the potential for cost overruns. To the extent our actual costs exceed the estimates upon which the price was negotiated, we will generate less than the anticipated amount of profit or could incur a loss.

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

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

Under certain performance-based contract arrangements, we are paid only to the extent our customer actually realizes savings or achieves some other performance-based improvements that result from our services. In addition, we may also incur certain penalties. Performance-based contracts could impose substantial costs and risks, including:

the need to accurately understand and estimate in advance the improved performance that might result from our services;

the lack of experience both we and our primary customers have in using this type of contract arrangement; and

the requirement that we incur significant expenses with no guarantee of recovering these expenses or realizing a profit in the future. Even if we successfully execute a performance-based contract, our interim operating results and cash flows may be negatively affected by the fact that we may be required to incur significant up-front expenses prior to realizing any related revenue.

---

## **Table of Contents**

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

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

the additional costs associated with evaluating, qualifying, and negotiating such opportunities;

a requirement to understand and comply with the specific procurement laws and/or regulations of each individual state, locality, other government, international entity, or other party with special standing;

the contractual acceptance of liability provisions that impose, for example, liquidated damages or other monetary damages in excess of the amount of services we provide, which in some cases are unlimited;

the unavailability of certain protections that would typically be available under federal or common law; and

an increased risk of additional costs associated with dispute resolution.

***International sales may pose potentially greater risks.***

International business may pose greater risks than domestic business due to the potential for changes in foreign economic, regulatory and political environments. International business may also be highly sensitive to changes in foreign national priorities and government budgets.

Work performed in foreign locations may be subject to foreign income and other taxes. We will incur costs in monitoring and complying with the tax laws and regulations in the various foreign locations where we do business, and these costs could be significant. Among other things, we could face scrutiny of transfer pricing arrangements by authorities in countries in which we operate. Failure to comply with all foreign tax laws and regulations may result in penalties and interest in addition to any tax liability owed. There are also U.S. and international regulations relating to investments, exchange controls and repatriation of earnings, as well as varying currency, political and economic risks.

It may be more difficult to enforce contracts and collect accounts receivable in foreign markets, and we may encounter longer payment cycles. In addition, some countries may provide reduced protection for our intellectual property rights. We will also be required to comply with complex U.S. laws regulating the export of technology.

***We may not be successful in identifying acquisition candidates and, if we undertake acquisitions, they could be expensive, increase our costs or liabilities, or disrupt our business. Additionally, if we are unable to successfully integrate companies we acquire, our revenue and operating results may be impaired.***

One of our strategies is to augment our organic growth through acquisitions. We have completed nine acquisitions of complementary companies that provide services in one of our three target markets. We may not be able to identify suitable acquisition candidates at prices that we consider appropriate or to finance acquisitions on terms that are satisfactory to us. Acquisitions of businesses or other material operations may require additional debt or equity financing, resulting in leverage or dilution of ownership. Additionally, negotiations of potential acquisitions and the integration of acquired business operations could disrupt our business by diverting management attention away from day-to-day operations and we may not be able to successfully integrate the companies we acquire. We also may not realize cost efficiencies or synergies that we anticipated when selecting our acquisition candidates. Acquired companies may have liabilities or adverse operating issues that we fail to discover through due diligence. Any costs, liabilities, or disruptions associated with future acquisitions could harm our operating results. In addition, following the integration of acquired companies, we may experience increased attrition, including but not limited to key employees of acquired companies, which could reduce our future revenue.

## Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

Our most recent acquisition of Constella Group, LLC, or Constella, is our largest acquisition to date. While substantially all of Constella's revenues are generated in the health care and public health market, primarily under contracts with the U.S. government, approximately 40% of Constella's revenues are from work performed outside the United States, and approximately 30% of its revenues are from commercial contracts primarily with customers in the pharmaceutical industry. The Constella acquisition expands our capabilities in the health care and public health market, but also exposes us to greater risks related to international and commercial work. We will likely be required to devote significant management attention and resources to manage and staff Constella's international operations and we expect to incur increased travel, infrastructure and legal compliance costs associated with multiple international locations. In particular, Constella's decentralized operations and financial systems will require us to incur significant costs to upgrade internal controls to become compliant with the Sarbanes Oxley Act of 2002.

---

**Table of Contents**

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

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

Audits for costs incurred on work performed after fiscal year 2005 have not yet been completed. In addition, non-audit reviews by the government may still be conducted on all our government contracts. If a government audit uncovers improper or illegal activities, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines, and suspension or debarment from doing business with U.S. federal government agencies. In addition, we could suffer serious harm to our reputation if allegations of impropriety were made against us, whether or not true.

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

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

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

lose revenue due to adverse client reaction;

be required to provide additional services to a client at no charge;

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

suffer claims for substantial damages against us.

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

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

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

Our business involves providing services that require our employees to operate in various countries around the world, including Iraq. These countries may be experiencing political upheaval or unrest, and in some cases war or terrorism. Senior level employees or executives may, on occasion, be part of the teams deployed to provide services in these countries. As a result, it is possible that certain of our employees or

executives will suffer injury or bodily harm in the course of these

## **Table of Contents**

deployments. It is also possible that we will encounter unexpected costs in connection with additional risks inherent with sending our employees to dangerous locations, such as increased insurance costs, as well as the repatriation of our employees or executives for reasons beyond our control.

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

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

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

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

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

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

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

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

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



## **Table of Contents**

### ***We may be harmed by intellectual property infringement claims.***

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

cease selling or using products or services that incorporate the challenged software or technology;

obtain a license or additional licenses from our vendors or other third parties; or

redesign our products and services that rely on the challenged software or technology.

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

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

As of June 30, 2007 we had approximately 200 employees who serve as reserves for a branch of the military or the National Guard. In the event of a significant call-up we will pay these employees the differential between their military pay and their salary for up to one year. Our standard practice in the absence of a significant call-up is to provide for up to 15 days of differential pay for military leave. To the extent those called for military duty are directly billable on our contracts, our revenue could be reduced. Additionally, our fringe benefit expenses would be increased by any differential payments, which could reduce our profits.

### **Other Risks Related To Our Stock**

#### ***Our stock price is volatile and could decline.***

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

our operating performance and the performance of other similar companies or companies deemed to be similar;

actual or anticipated differences in our quarterly operating results;

changes in our revenue or earnings estimates or recommendations by securities analysts;

publication of research reports about us or our industry by securities analysts;

## Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

additions and departures of key personnel;

contract mix and the extent of use of subcontractors;

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

federal government spending levels, both generally and by our particular government clients;

the passage of legislation or other regulatory developments that adversely affect us or our industry;

the failure by Congress to approve budgets on a timely basis;

speculation in the press or investment community;

## **Table of Contents**

changes in the government information technology services industry;

changes in accounting principles;

terrorist acts;

general market conditions, including economic factors unrelated to our performance; and

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

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

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

As of August 10, 2007, Ernst Volgenau, our chairman, beneficially owned 112,768 shares of class A common stock and 12,050,736 shares of class B common stock, which represented approximately 65.1% of the combined voting power of our outstanding common stock. As of August 10, 2007, our executive officers, directors and former chairman of the board of directors as a group beneficially owned an aggregate of 2,122,244 shares of class A common stock and 14,199,828 shares of class B common stock, which represented approximately 77.3% of the combined voting power of our outstanding common stock. As a result, these individuals acting together, or Dr. Volgenau acting alone, will be able to control the outcome of all matters that our stockholders vote upon, including the election of directors, amendments to our certificate of incorporation, and mergers or other business combinations. In addition, upon the death of Dr. Volgenau and the conversion of his class B common stock into class A common stock, William K. Brehm, the former chairman of our board of directors, if he survives Dr. Volgenau, would beneficially own all of the outstanding class B common stock and could exercise significant influence over corporate matters requiring stockholder approval. This concentration of ownership and voting power may also have the effect of delaying or preventing a change in control of our company and could prevent stockholders from receiving a premium over the market price if a change in control is proposed.

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

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

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

the high-vote nature of our class B common stock;

only one of the three classes of directors is elected each year;

stockholders have limited ability to remove directors without cause;

## Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

stockholders cannot take actions by written consent;

stockholders cannot call a special meeting of stockholders; and

stockholders must give advance notice to nominate directors or submit proposals for consideration at stockholder meetings.

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

## **Table of Contents**

### **Item 1B. UNRESOLVED STAFF COMMENTS**

We have not received written comments from the commission staff regarding our periodic or current reports under the Securities Exchange Act of 1934 that remain unresolved.

### **Item 2. PROPERTIES**

We lease our office facilities and we do not own any facilities or real estate. We have leased our corporate headquarters at 4300 Fair Lakes Court in Fairfax, Virginia 22033 since 1991. Both of our headquarters leases expire on December 31, 2015. We also lease facilities in the following locations:

Alexandria, Virginia	Fort Walton Beach, Florida	Rockville, Maryland
Arlington, Virginia	Hatboro, Pennsylvania	Sacramento, California
Atlanta, Georgia	Herndon, Virginia	San Antonio, Texas
Baltimore, Maryland	Jacksonville, FL	San Diego, California
Boston, MA	Kingstowne, Virginia	Seattle, Washington
Chesapeake, Virginia	Landover, Maryland	Shrewsbury, New Jersey
College Park, Georgia	Lexington Park, Maryland	St. Louis, MO
Colorado Springs, Colorado	Minneapolis, Minnesota	Warner Robins, Georgia
Columbia, Maryland	New York, New York	Washington, DC
Dayton, Ohio	Newport Beach, California	
Durham, North Carolina	Newport News, Virginia	
Eatontown, New Jersey	Panama City, FL	
Egg Harbor Township, New Jersey	Portsmouth, New Hampshire	
Falls Church, Virginia	Portsmouth, New Hampshire	
Fayetteville, North Carolina	Reston, Virginia	

In addition, we have employees who work on engagements at other smaller operating locations around the United States.

### **Item 3. LEGAL PROCEEDINGS**

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

### **Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

During the fourth quarter of fiscal year 2007, there were no matters submitted to a vote of security holders through the solicitation of proxies or otherwise.

**Table of Contents****PART II****Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

On May 2, 2005, our board of directors declared a two-for-one stock split in the form of a 100 percent stock dividend on our common stock. The dividend was paid on May 27, 2005 to shareholders of record on May 13, 2005.

Since May 24, 2002, our class A common stock has been publicly traded on the New York Stock Exchange under the symbol SRX. Prior to May 24, 2002, our class A common stock was not publicly traded. From July 1, 2005 to June 30, 2007 the ranges of high and low sale prices of our class A common stock as reported by the New York Stock Exchange for each quarter during this period were as follows:

	<b>High</b>	<b>Low</b>
Year ended June 30, 2007:		
First Quarter	\$ 30.31	\$ 23.31
Second Quarter	32.40	25.50
Third Quarter	28.19	20.65
Fourth Quarter	26.38	23.95
Year ended June 30, 2006:		
First Quarter	\$ 38.29	\$ 32.21
Second Quarter	35.75	27.40
Third Quarter	38.28	30.15
Fourth Quarter	37.73	26.63

As of August 10, 2007, there were approximately 93 holders of record of our class A common stock and two holders of record of our class B common stock. The number of holders of record of our class A common stock is not representative of the number of beneficial holders because many shares are held by depositories, brokers or nominees. As of August 3, 2007, the closing price of our class A common stock was \$24.38.

We have never declared or paid any cash dividends on our common stock. We currently intend to retain earnings, if any, to support our growth strategy and do not anticipate paying cash dividends in the foreseeable future.

***Sale of Unregistered Securities***

We issued 46,392, 56,142, and 107,730 shares of our class A common stock to our SRA International, Inc. 401(k) Plan through matching contributions as determined by our board of directors during the fiscal years ended June 30, 2007, 2006, and 2005, respectively. These issuances were not sales within the meaning of the Act.

***Share Repurchases***

Our Board of Directors has authorized the repurchase of up to \$40 million of our class A common stock. The timing, price, quantity and manner of the purchases can be determined at the discretion of our chief executive officer. We have not repurchased any shares in accordance with this authorization.

***Equity Compensation Plan Information***

Information regarding our equity compensation plans and the securities authorized for issuance thereunder is incorporated by reference in Item 12.

## **Table of Contents**

### ***Stock Performance Graph***

The information included under this heading **Stock Performance Graph** is furnished and not filed and shall not be deemed to be soliciting material or subject to Regulation 14A, shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or the Exchange Act, or otherwise subject to the liabilities of that section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933, as amended, or the Exchange Act.

The following graph compares the cumulative total stockholder return on our class A common stock from June 30, 2002 to June 30, 2007 with the cumulative total return of (i) the Russell 2000 stock index and (ii) the services sector index of the Goldman Sachs Technology Index, or the GSTI services index. This graph assumes the investment of \$100.00 at the closing price on June 30, 2002 in our class A common stock, the Russell 2000 stock index, and the GSTI services index, and assumes any dividends are reinvested. The historical information set forth below is not necessarily indicative of future performance.

	2002	2003	2004	June 30, 2005	2006	2007
SRA International, Inc.	100.00	118.61	156.86	257.38	197.41	187.25
Russell 2000	100.00	98.36	131.18	143.57	164.50	191.53
GSTI Services Index	100.00	90.35	105.06	103.60	121.08	150.65

**Table of Contents****Item 6. SELECTED FINANCIAL DATA**

The following selected financial data should be read in conjunction with our financial statements and the related notes, and with Management's Discussion and Analysis of Financial Condition and Results of Operations, included elsewhere in this Form 10-K. The statement of operations data for the fiscal years ended June 30, 2007, 2006, and 2005, and the balance sheet data as of June 30, 2007 and 2006, are derived from our financial statements that have been audited by Deloitte & Touche LLP, our independent registered public accounting firm, and are included in this Form 10-K. The statement of operations data for the fiscal years ended June 30, 2004 and 2003, and the balance sheet data as of June 30, 2005, 2004, and 2003, are derived from our financial statements that have been audited by Deloitte & Touche LLP and not included in this Form 10-K. The selected financial data reflect our adoption of Statement of Financial Accounting Standards, or SFAS, No. 123R in July 2005 and our acquisitions of Adroit Systems, Inc. in January 2003, ORION Scientific Systems in January 2004, Touchstone Consulting Group in April 2005, Galaxy Scientific Corporation in July 2005, Spectrum Solutions Group, Inc. in November 2005, Mercomms Unlimited, Inc. in April 2006, and RABA Technologies, LLC in October 2006. For more information on these more recent acquisitions, see Note 16 to our financial statements.

	Year Ended June 30,				
	2007	2006	2005	2004	2003
	(in thousands, except share and per share data)				
Statement of Operations Data:					
Revenue	\$ 1,268,872	\$ 1,179,267	\$ 881,770	\$ 615,802	\$ 450,375
Operating costs and expenses:					
Cost of services	954,656	880,802	653,115	442,771	316,672
Selling, general and administrative (b)	200,204	183,297	126,404	100,919	82,753
Depreciation and amortization	21,187	18,201	13,141	10,511	8,962
Total operating costs and expenses	1,176,047	1,082,300	792,660	554,201	408,387
Operating income	92,825	96,967	89,110	61,601	41,988
Interest income (expense), net	6,276	4,232	3,442	1,474	1,387
Gain on equity method investment					1,031
Gain on sale of Assentor practice					4,685
Gain on sale of Mantas, Inc.	3,674				
Other income				153	
Income before taxes	102,775	101,199	92,552	63,228	49,091
Provision for income taxes	39,345	38,679	34,829	24,291	19,431
Net income	\$ 63,430	\$ 62,520	\$ 57,723	\$ 38,937	\$ 29,660
Earnings per share: (a)					
Basic	\$ 1.12	\$ 1.14	\$ 1.09	\$ 0.76	\$ 0.69
Diluted	\$ 1.09	\$ 1.08	\$ 1.02	\$ 0.71	\$ 0.62
Weighted-average shares: (a)					
Basic	56,476,927	55,064,138	52,965,623	51,008,978	42,690,310
Diluted	58,381,788	57,738,875	56,549,303	54,738,028	47,459,972
	As of June 30,				
	2007	2006	2005	2004	2003
Balance Sheet Data:					
Cash and cash equivalents	\$ 212,034	\$ 173,564	\$ 162,973	\$ 143,367	\$ 158,264
Short-term investments	85	9,834	20,156	9,076	433
Working capital	297,085	299,567	285,489	229,796	219,655



## Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

Total assets	847,684	724,722	572,399	466,380	367,651
Total stockholders' equity	625,455	533,297	429,092	339,268	283,015

(a) Share and per share amounts have been adjusted to reflect the May 2005 two-for-one stock split.

(b) Years ended June 30, 2007 and 2006 include \$11.5 million and \$13.2 million, respectively, of stock compensation expense recognized in accordance with SFAS No. 123R.

---

**Table of Contents**

**Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*You should read the following discussion and analysis in conjunction with our financial statements and the related notes included elsewhere in this Form 10-K. This discussion and analysis contains forward-looking statements that involve risks, uncertainties, and assumptions. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but not limited to, those set forth under RISK FACTORS and elsewhere in this Form 10-K.*

**ABOUT THIS MANAGEMENT'S DISCUSSION AND ANALYSIS**

The discussion and analysis that follows is organized to:

provide an overview of our business;

describe selected key metrics evaluated by management;

explain the year-over-year trends in our results of operations;

describe our liquidity and capital resources; and

explain our critical accounting policies, describe certain line items of our statements of operations, and define certain other terms we use in our discussion and analysis.

Readers who are not familiar with our company or the financial statements of federal government information technology services providers should closely review the DESCRIPTION OF CRITICAL ACCOUNTING POLICIES, the DESCRIPTION OF STATEMENT OF OPERATIONS ITEMS, and the DEFINITION OF CERTAIN TERMS USED IN THIS MANAGEMENT'S DISCUSSION AND ANALYSIS sections that appear at the end of this discussion and analysis. These sections provide background information that can help readers in understanding and analyzing our financial information.

**OVERVIEW**

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

Since our founding in 1978 we have derived substantially all of our revenue from services provided to federal government clients. Although the federal information technology market is currently facing challenges as a result of the shift in expenditures to pay for the war against terrorism and other international conflicts, we believe that the federal government's spending on IT will continue to increase over the next several years. According to the *Federal IT Market Forecast, FY2007 - FY2012* report published by INPUT, an independent federal government market research firm, the contracted portion of the federal government spending on information technology budget is forecasted to grow at a compound annual growth rate of 5.6% over the next five years. In order to grow more rapidly than the market, we will need to take market share from our competitors. Our growth is driven in part by contract awards and how we build-out our contracts. Ideally, the level of quarterly business awards would exceed the revenue booked in the quarter to drive backlog growth.

In the near term, we face some uncertainties due to the current business environment. First, the Department of Defense continues to divert funding away from certain information technology initiatives to support the war against terrorism and the reconstruction of Iraq. Second, all civil

## Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

agencies are operating under a continuing resolution through the end of the government's fiscal year ending September 30, 2007, limiting spending for most agencies to the fiscal 2006 level. The resulting budget tightness has slowed industry growth. As growth has slowed in these areas of our market, we have experienced pricing pressure on new business opportunities. Increased competition, combined with the shortage of experienced contracting staff among government agencies, has increased the frequency of contract protests, which has in turn caused delays in many new awards. Additionally, it is difficult to hire and retain highly qualified individuals who have advanced technology and technical services skills and who work well with our clients in a government environment, especially those with security clearances.

## **Table of Contents**

We work with the federal government under three primary contract types: cost-plus-fee, time-and-materials, and fixed-price contracts. Cost-plus-fee contracts are typically lower risk arrangements and thus yield lower profit margins than time-and-materials and fixed-price arrangements. Time-and-materials and fixed-price contracts typically generate higher profit margins reflecting their generally higher risk. Where customer requirements are clear, we prefer to enter into time-and-materials and fixed-price arrangements rather than cost-plus-fee arrangements. Typically under time-and-materials and fixed-price, as compared with cost-plus-contracts, the customer can save money and we can earn better margins, given the more specific delivery requirements of these structures.

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

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

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

Depreciation and amortization expenses are affected by the level of our annual capital expenditures and the amount of identified intangibles related to acquisitions. We do not presently foresee significant changes in our capital expenditure requirements, which have been approximately 1.0% to 2.0% of revenue over the last three fiscal years. As we continue to make selected strategic acquisitions, the amortization of identified intangible assets may increase as a percentage of our revenue.

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

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

## **SELECTED KEY METRICS EVALUATED BY MANAGEMENT**

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

### ***Revenue Growth***

Our revenue growth is primarily organic, but has been augmented by selective strategic acquisitions. Our total revenue growth rate was 7.6% in fiscal year 2007. Our organic revenue growth rate was 3.4% in fiscal year 2007, driven by building-out existing accounts, broadening our client base, and leveraging our research and development into high value services. The table below details our largest contract awards that have contributed to our organic growth:



**Table of Contents**

Client	Contract	Period of Performance		Initial Contract Award Value (in millions)
Federal Deposit Insurance Corporation	Technology Infrastructure Support	September 2004	September 2009	\$ 341.0
U.S. Agency for International Development	PRIME 2.2 Enterprise Wide IT Services	December 2003	January 2010	328.0
Environmental Protection Agency	Information Technology Solutions-Business Information Strategic Support (ITS-BISS)	April 2005	April 2010	148.0
National Guard Bureau	Advanced Information Technology Services	March 2003	September 2007	115.0
Government Accountability Office	IT Infrastructure Support	February 2003	February 2009	105.0

A part of our growth strategy includes pursuing acquisitions. As of June 30, 2007, we have made the following acquisitions:

Acquisition	Strategic Value	Closing Date	Purchase Price (in millions)
The Marasco Newton Group, Ltd.	Environment	January 4, 2002	\$ 16.2
Adroit Systems, Inc.	Command and Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance (C4ISR)	January 31, 2003	38.3
ORION Scientific Systems	Counterterrorism	January 30, 2004	34.7
Touchstone Consulting Group, Inc.	Strategic Consulting	April 21, 2005	37.0
Galaxy Scientific Corporation	Command and Control, Communications, Computers, Intelligence (C4I)	July 1, 2005	98.7
Spectrum Solutions Group, Inc.	Enterprise Resource Planning	November 2, 2005	17.7
Mercomms Unlimited, Inc.	Maritime and Defense Communications	April 10, 2006	0.6
RABA Technologies, LLC	Intelligence	October 26, 2006	95.0

**Contract Backlog**

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

	2007	Year Ended June 30, 2006		2005
		(in millions)		
Backlog:				
Funded	\$ 600.4	\$ 512.8	\$ 453.2	
Unfunded	2,809.8	2,748.8	2,296.9	
Total backlog	\$ 3,410.2	\$ 3,261.6	\$ 2,750.1	

Our total backlog of approximately \$3.4 billion as of June 30, 2007 represented a 4.6% increase over the fiscal year 2006 backlog. We currently expect to recognize revenue during fiscal year 2008 from approximately 25% of our total backlog as of June 30, 2007.

**Contract mix**

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



**Table of Contents**

	Year Ended June 30,		
	2007	2006	2005
Cost-plus-fee	43%	45%	46%
Time-and-materials	42	40	34
Fixed-price	15	15	20

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

**Headcount and Labor Utilization**

Because most of our revenue derives from services delivered by our employees, our ability to hire new employees and deploy them on direct-billable jobs is critical to our success. The following table represents our headcount and our direct labor utilization over the past three years:

	Year Ended June 30,		
	2007	2006	2005
Headcount	5,215	4,975	4,177
Direct labor utilization	78.8%	78.5%	78.8%

**Operating Margin**

Operating margin, or the ratio of operating income to revenue, is affected by the mix of our contracts and how we manage our costs. Our operating margins were 7.3%, 8.2%, and 10.1% for the years ended June 30, 2007, 2006, and 2005, respectively. The decrease in operating margin between fiscal 2006 and 2007 is primarily attributable to lower margins on recompleted contracts during fiscal 2007 compared to fiscal 2006. Additionally, the amortization associated with identified intangibles recorded as a result of our acquisition of RABA Technologies, LLC, or RABA, reduced operating margin in the year ended June 30, 2007. The decrease in operating margin between fiscal 2005 and 2006 is primarily due to the compensation expense related to share-based payment transactions recognized in accordance with the adoption of SFAS No. 123R on July 1, 2005.

**Days Sales Outstanding**

Days sales outstanding, or DSO, is a measure of how efficiently we manage the billing and collection of our accounts receivable, our most significant working capital requirement. Accounts receivable represents the most significant asset we report on our balance sheet. We reported DSO of 73 and 74 days for the year ended June 30, 2007 and 2006, respectively. The decrease in DSO was due to continued initiatives to improve our invoicing and collections processes.



**Table of Contents****RESULTS OF OPERATIONS**

The following tables set forth some items from our consolidated statements of operations, and these items expressed as a percentage of revenue, for the periods indicated.

	2007	% Change	Year Ended June 30, 2006 (in thousands)	% Change	2005
Revenue	\$ 1,268,872	7.6%	\$ 1,179,267	33.7%	\$ 881,770
Operating costs and expenses:					
Cost of services	954,656	8.4	880,802	34.9	653,115
Selling, general, and administrative (a) (b)	200,204	9.2	183,297	45.0	126,404
Depreciation and amortization	21,187	16.4	18,201	38.5	13,141
Total operating costs and expenses	1,176,047	8.7	1,082,300	36.5	792,660
Operating income	92,825	(4.3)	96,967	8.8	89,110
Interest income, net	6,276	48.3	4,232	23.0	3,442
Gain on sale of Mantas, Inc.	3,674	100.0			
Income before taxes	102,775	1.6	101,199	9.3	92,552
Provision for income taxes	39,345	1.7	38,679	11.1	34,829
Net income	\$ 63,430	1.5%	\$ 62,520	8.3%	\$ 57,723

  

	(as a percentage of revenue)		
Revenue	100.0%	100.0%	100.0%
Operating costs and expenses:			
Cost of services	75.2	74.7	74.1
Selling, general and administrative (b)	15.8	15.5	14.3
Depreciation and amortization	1.7	1.5	1.5
Total operating costs and expenses	92.7	91.8	89.9
Operating income	7.3	8.2	10.1
Interest income, net	0.5	0.4	0.4
Gain on sale of Mantas, Inc.	0.3		
Income before taxes	8.1	8.6	10.5
Provision for income taxes	3.1	3.3	4.0
Net income	5.0%	5.3%	6.5%

(a) Years ended June 30, 2007 and 2006 include \$11.5 million and \$13.2 million, respectively, of stock compensation expense recognized in accordance with SFAS No. 123R.

(b) Excluding the SFAS No 123R expense, selling, general, and administrative expense would have been 14.9% and 14.4% of revenue in fiscal 2007 and 2006, respectively.

**Revenue**

## Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

Our revenue increased 7.6% to \$1.27 billion in fiscal 2007 from \$1.18 billion in fiscal 2006. Organic revenue growth was 3.4% for the year, with the remainder of growth mostly attributable to our October 2006 acquisition of RABA which generated approximately \$43 million in revenue during fiscal 2007. Our organic growth has been driven primarily by our Federal Deposit Insurance Corporation, or FDIC, contract, which generated approximately \$25.5 million in additional revenue during fiscal 2007 compared to fiscal 2006.

Our revenue increased 33.7% to \$1.18 billion in fiscal 2006, from \$881.8 million in fiscal 2005. Organic revenue growth was 17.2% for the year, with the remainder of growth mostly attributable to our April 2005 and July 2005 acquisitions of Touchstone and Galaxy, respectively. Our organic growth has been driven in part by three large contracts, representing approximately 7.8% of our fiscal 2006 organic growth. Our FDIC contract, our Advanced Information Technology Services, or AITS, contract with the National Guard, and our United States Agency for International

## **Table of Contents**

Development, or USAID, contract were significant drivers of our revenue growth, generating approximately \$79 million of additional revenue during fiscal 2006 compared to fiscal 2005.

### ***Cost of Services***

Cost of services increased 8.4% to \$954.7 million in fiscal 2007, from \$880.8 million in fiscal 2006. This increase in cost of services was due primarily to the increased volume of services provided under our FDIC contract, and the volume of services attributable to RABA's existing contracts. As a percentage of revenue, cost of services increased to 75.2% in fiscal 2007, from 74.7% in fiscal 2006. This increase as a percentage of revenue was attributable primarily to lower margin on a re-competed contract during fiscal 2007 compared to fiscal 2006.

Cost of services increased 34.9% to \$880.8 million in fiscal 2006, from \$653.1 million in fiscal 2005. This increase in cost of services was due primarily to the increased volume of services provided under our FDIC, AITS, and USAID contracts, and the volume of services attributable to Touchstone's and Galaxy's contracts. As a percentage of revenue, cost of services increased to 74.7% in fiscal 2006, from 74.1% in fiscal 2005. This increase as a percentage of revenue was attributable primarily to an increased amount of direct material purchases made by us and delivered to clients in connection with our services. Typically, direct material purchases generate lower profit, which increases the ratio of cost of services to revenue. While this higher direct material content can drive our operating margin down, it should have a positive impact on our earnings and return on invested capital.

### ***Selling, General and Administrative Expenses***

Selling, general and administrative expenses increased 9.2% to \$200.2 million in fiscal 2007, from \$183.3 million in fiscal 2006. As a percentage of revenue, selling, general and administrative expenses increased to 15.8% in fiscal 2007 from 15.5% in fiscal 2006. This increase as a percentage of revenue resulted primarily from an increase in our allowance for doubtful accounts related to a potentially uncollectible receivable. Additionally, increased spending to recruit and retain staff during fiscal 2007 increased the ratio of selling, general and administrative expenses to revenue as compared to fiscal 2006.

Selling, general and administrative expenses increased 45.0% to \$183.3 million in fiscal 2006, from \$126.4 million in fiscal 2005. As a percentage of revenue, selling, general and administrative expenses increased to 15.5% in fiscal 2006 from 14.3% in fiscal 2005. This increase as a percentage of revenue resulted primarily from the adoption of SFAS No. 123R on July 1, 2005. Under SFAS No. 123R, share-based payments not fully vested as of July 1, 2005 and those granted in the year ended June 30, 2006 and future periods are measured at estimated fair value and included in selling, general and administrative expenses over the appropriate earning period. We recognized approximately \$13.2 million of compensation costs in accordance with SFAS No. 123R in fiscal 2006. Excluding the impact of SFAS No. 123R, selling, general and administrative expenses as a percentage of revenue was 14.4% and 14.3% for the years ended June 30, 2006 and 2005, respectively. This increase as a percentage of revenue resulted primarily from increased costs associated with bid and proposal efforts and lower revenue due to the related transition of professional staff off of billable engagements to support the higher proposal activity.

### ***Depreciation and Amortization***

Depreciation and amortization increased 16.4% to \$21.2 million in fiscal 2007, from \$18.2 million in fiscal 2006. As a percentage of revenue, depreciation and amortization increased to 1.7% in fiscal 2007, from 1.5% in fiscal 2006. This increase in depreciation and amortization resulted primarily from the amortization associated with the identified intangibles recorded as a result of our acquisition of RABA.

Depreciation and amortization increased 38.5% to \$18.2 million in fiscal 2006, from \$13.1 million in fiscal 2005. This increase in depreciation and amortization resulted primarily from the amortization associated with the identified intangibles recorded as a result of our acquisitions of Galaxy and Spectrum. As a percentage of revenue, depreciation and amortization was 1.5% in both fiscal 2006 and 2005.

### ***Interest Income, net***

Interest income, net increased to \$6.3 million in fiscal 2007, from \$4.2 million in fiscal 2006. This increase was due to a general rise in interest rates and a greater average cash and cash equivalents balance.

Interest income, net increased to \$4.2 million in fiscal 2006, from \$3.4 million in fiscal 2005. This increase was due to a general rise in interest rates and interest earned on amended tax return refunds from previous years.



## **Table of Contents**

### ***Income Taxes***

In fiscal 2007, our effective income tax rate increased slightly to 38.3%, from 38.2% in fiscal year 2006. In fiscal 2006 our effective tax rate increased to 38.2% from 37.6% in fiscal 2005. This increase was due primarily to additional services performed in higher taxing jurisdictions. The estimated effective tax rate is based on current tax law and current income and expense projections. The effective tax rate may be affected by future acquisitions, by changes in interest income from tax-advantaged municipal bond investments, or by the receipt of certain tax credits or refunds.

### **SEASONALITY**

Our quarterly operating margins are affected by, among other things, seasonality in our business model. We may experience a sequential decline in operating margins between our quarter ending June 30 and our quarter ending September 30. In the quarter ending September 30, we generally experience lower staff utilization rates. These lower utilization rates are attributable both to summer vacations and to increased proposal activity in connection with the end of the federal fiscal year. We typically transition a significant number of professional staff temporarily off of billable engagements to support this increased proposal activity.

### **LIQUIDITY AND CAPITAL RESOURCES**

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

As of June 30, 2007, our total cash and investments balances were \$212.1 million. We used a total of approximately \$102.2 million of cash in fiscal 2007 related to the acquisitions of RABA and Spectrum.

From our May 2002 initial public offering through June 30, 2007, we have been able to meet all of our liquidity requirements with cash generated from our operations. We believe we have adequate capital resources to fund our operating and liquidity and capital expenditure needs through at least fiscal 2008, and that our funds on hand and borrowing capacity are sufficient to execute our financial and operating strategy for the foreseeable future.

### ***Cash Flow***

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

### ***Fiscal 2007 Compared to Fiscal 2006***

Net cash provided by operating activities was \$122.4 million in fiscal 2007, compared to \$86.8 million in fiscal 2006, or 1.9 and 1.4 times net income for fiscal 2007 and 2006 respectively. The higher cash provided by operating activities was driven primarily by increased customer collections as a result of internal process initiatives implemented to improve our invoicing and collection of accounts receivable. Additionally, the payment of year-end incentive compensation was made after year-end, whereas in prior years such payments were made in June of each year.

We used \$101.2 million in net cash for investing activities in fiscal 2007, compared to \$104.7 million in fiscal 2006. Three factors drive our investing cash outflows: capital expenditures, the purchase, sale or maturity of investments with maturities that exceed 90 days, and acquisitions. The lower cash used for investing activities in fiscal 2007 was due primarily to lower cash generated from the sale and maturity of investments in fiscal 2007 compared to fiscal 2006 which was partially offset by the proceeds received in the sale of our interest in Mantas, Inc.

Net cash provided by financing activities was \$17.2 million in fiscal 2007, compared to \$28.5 million in fiscal 2006. The decrease was due to lower stock option exercises and related tax benefits.

## **Table of Contents**

### *Fiscal 2006 Compared to Fiscal 2005*

Net cash provided by operating activities was \$86.8 million in fiscal 2006, compared to \$66.0 million in fiscal 2005, or 1.4 and 1.1 times net income for fiscal 2006 and 2005, respectively. The ratio of cash provided by operating activities to net income in fiscal 2006 was positively affected by the increase in our accounts payable and accrued expenses balance. Account payable and accrued expenses increased due to the timing of certain vendor payments. Net cash provided by operating activities in fiscal 2006 was also affected by the adoption of SFAS No. 123R, which resulted in the reclassification of excess tax benefits from operating cash flows to financing cash flows.

We used \$104.7 million in net cash for investing activities in fiscal 2006, compared to \$61.0 million in fiscal 2005. The higher amount of cash used was primarily the result of our acquisitions of Galaxy and Spectrum in July 2005 and November 2005, respectively. We spent approximately \$68.0 million more on acquisitions in fiscal 2006 than fiscal 2005.

Net cash provided by financing activities was \$28.5 million in fiscal 2006, compared to \$14.6 million in fiscal 2005. The higher amount of cash provided by financing activities in the fiscal 2006 was primarily the result of our adoption of SFAS No. 123R in July 2005. Under SFAS No. 123R, excess tax benefits from share-based payments are presented as sources of financing activity cash flows.

### ***Credit Facility and Borrowing Capacity***

#### **Acquisition of Constella Group, LLC**

On August 9, 2007, we completed our acquisition of all of the outstanding stock of Constella Group LLC, or Constella, for approximately \$186.9 million in cash. Approximately \$51.6 million of the purchase price was used to repay all outstanding debt obligations of Constella on the closing date. Approximately \$16.0 million was placed into escrow as security for the payment, if any, of post-closing net asset adjustments and to secure indemnification obligations. The equity purchase agreement has been filed as Exhibit 2.2 to this report. Constella is a privately-held provider of global health consulting services. Headquartered in Durham, NC, Constella is organized by three interrelated service offerings: domestic health sciences, international health development and global drug development. Financing for the acquisition consisted of available cash and borrowings under a credit facility obtained prior to closing.

#### **Revolving Credit Facility**

On August 9, 2007, we entered into a \$100.0 million five-year unsecured revolving credit facility. The agreement has an accordion feature enabling the credit facility to be increased by an additional \$100.0 million, subject to specified conditions. Outstanding borrowings under the agreement bear interest at a LIBOR based interest rate (currently LIBOR plus 75 basis points). Interest is payable throughout the period a borrowing is outstanding. We borrowed \$100.0 million under this credit line to fund part of the acquisition of Constella.

#### **STOCK PURCHASE AGREEMENT**

On August 30, 2005, we and our chairman of the board of directors terminated a stock purchase agreement that required us to repurchase shares from the chairman's estate upon his death. We had purchased term life insurance policies on our chairman to meet these repurchase obligations. We have terminated all related term life insurance policies. Expenses recognized under these policies were \$49,000 for the year ended June 30, 2005.

#### **OFF-BALANCE SHEET ARRANGEMENTS**

We do not have any off-balance sheet arrangements.

#### **CONTRACTUAL OBLIGATIONS**

The following table summarizes our contractual obligations as of June 30, 2007 that require us to make future cash payments. For contractual obligations, we included payments that we have an unconditional obligation to make. We did not include amounts already recorded on our balance sheet as liabilities at June 30, 2007.

**Table of Contents**

Contractual obligations:	Total	Payments due by period			
		Less than 1 Year	Years 2 and 3	Years 4 and 5	After 5 Years
		(in thousands)			
Operating lease obligations, net	\$ 171,171	\$ 28,971	\$ 49,834	\$ 35,744	\$ 56,622
Total contractual obligations	\$ 171,171	\$ 28,971	\$ 49,834	\$ 35,744	\$ 56,622

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

**RELATED PARTY TRANSACTIONS**

In May 2001, Mantas, which was previously one of our service offerings, was contributed to a separate company, Mantas, Inc., which was formed with funding and other contributions received from unrelated third parties. Mantas, Inc. is a provider of services to the financial services industry to address anti-money laundering and other data mining issues. In fiscal 2005, we leased space and provided services to Mantas, Inc., for which we were reimbursed.

In October 2006, i-flex solutions completed its acquisition of Mantas, Inc. Our portion of the net sale proceeds was approximately \$4.4 million, including a portion to be held in escrow. We recognized a total pre-tax gain of approximately \$3.7 million during fiscal 2007. The remaining amount held in escrow will be recognized as a gain upon the release of funds pursuant to the terms of the escrow agreement.

**DESCRIPTION OF CRITICAL ACCOUNTING POLICIES**

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

**Revenue Recognition**

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

Absent evidence to the contrary, we recognize revenue as follows. Revenue on cost-plus-fee contracts is recognized to the extent of costs actually incurred plus a proportionate amount of the fee earned. We consider fixed fees under cost-plus-fee contracts to be earned in proportion to the allowable costs actually incurred in performance of the contract. Revenue on time-and-materials contracts is recognized based on the hours actually incurred at the negotiated contract billing rates, plus the cost of any allowable material costs and out-of-pocket expenses. Revenue on fixed-price contracts where we perform systems design, development and integration is recognized using the percentage-of-completion method of contract accounting. Unless it is determined as part of our regular contract performance review that overall progress on a contract is not consistent with costs expended to date, we determine the percentage completed based on the percentage of costs incurred to date in relation to total estimated costs expected upon completion of the contract. Revenue on fixed-price outsourcing and managed services contracts is generally recognized ratably over the contract period. Revenue on fixed-price strategic consulting contracts is generally recognized based on costs incurred because these services are directed by our customers and are subject to their needs which fluctuate throughout the contract period. We consider performance-based fees, including award fees, under any contract type to be earned when we can demonstrate satisfaction of performance goals, based upon historical experience, or we receive contractual notification from a client that the fee has been earned. Billings for hardware or software purchased by





## **Table of Contents**

customers under one of our contracts where we act as an agent to the transaction are excluded from our revenue and cost of services, except to the extent of any fee or profit earned.

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

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

We maintain reserves for doubtful accounts receivable that may arise in the normal course of business. This allowance for doubtful accounts is based on several factors, including the customer's payment history, the age of the accounts receivable, and management's judgment regarding the likelihood of collection. Historically, we have not had significant write-offs of doubtful accounts receivable related to work we perform for the federal government. However, we do perform work on contracts and task orders where, on occasion, issues arise that lead to accounts receivable not being collected. It is our policy to provide reserves for the collectibility of accounts receivable when we determine that it is probable that we will not collect all amounts due and the amount of the reserve requirements can be reasonably estimated.

### ***Contract Cost Accounting***

As a contractor providing services primarily to the federal government, we must categorize our costs as either direct or indirect and allowable or unallowable. Direct costs are those costs that are identified with specific contracts. These costs include labor, subcontractor and consultant services, third party materials we purchase under a contract, and other non-labor costs incurred in support of a contract. Indirect costs are those costs not identified with specific contracts. Rather, indirect costs are allocated to contracts in accordance with federal government rules and regulations. These costs typically include our selling, general and administrative expenses, fringe benefit expenses, and depreciation and amortization costs. Direct and indirect costs that are not allowable under the Federal Acquisition Regulation or specific contract provisions cannot be considered for reimbursement under our federal government contracts. We must specifically identify these costs to ensure we comply with these requirements. Our unallowable costs include a portion of our executive compensation, certain employee morale activities, certain types of legal and consulting costs, and the amortization of identified intangible assets, among others. A key element to our recent margin expansion has been our success at controlling indirect cost growth and unallowable costs. In addition, as we acquire and integrate new companies, we have been able to manage our indirect costs by realizing opportunities for cost synergies and integrating the indirect support function of acquired companies into our own.

### ***Accounting for Acquisitions and Asset Impairment***

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

We must evaluate goodwill for impairment on an annual basis, or during any interim period if we have an indication that goodwill may be impaired. We assess the potential impairment of goodwill by comparing the carrying value of the assets and liabilities of our reporting unit to which goodwill is assigned to the estimated fair value of the reporting unit using a discounted cash flow approach. We performed our annual goodwill impairment analysis as of January 1, 2007. There was no indication of goodwill impairment as a result of our impairment analysis. If we are required to record an impairment charge in the future, it could materially affect our results of operations.

The estimated fair market value of identified intangible assets is amortized over the estimated useful life of the related intangible asset. We have a process pursuant to which we typically retain third-party valuation experts to assist us in determining the fair market values and useful lives of identified intangible assets. We evaluate these assets for impairment when events occur that suggest a possible impairment. Such events could include, but are not limited to, the loss of a significant client or contract, decreases in federal government appropriations or funding for specific programs or contracts, or



## **Table of Contents**

other similar events. None of these events have occurred for the periods presented. We determine impairment by comparing the net book value of the asset to its future undiscounted net cash flows. If an impairment occurs, we will record an impairment expense equal to the difference between the net book value of the asset and its estimated discounted cash flows using a discount rate based on our cost of capital and the related risks of recoverability.

## **DESCRIPTION OF STATEMENT OF OPERATIONS ITEMS**

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

### ***Revenue***

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

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

*Cost-plus-fee contracts.* Cost-plus-fee contracts provide for reimbursement of allowable costs and the payment of a fee, which is our profit. Cost-plus-fixed-fee contracts specify the contract fee in dollars. Cost-plus-award-fee contracts may provide for a base fee amount, plus an award fee that varies, within specified limits, based upon the client's assessment of our performance as compared to contractual targets for factors such as cost, quality, schedule, and performance.

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

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

### ***Cost of Services***

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

### ***Selling, General and Administrative Expenses***

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

### ***Depreciation and Amortization***

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

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

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

**Table of Contents*****Backlog***

We define backlog to include funded and unfunded orders for services under existing signed contracts, assuming the exercise of all options relating to those contracts, less the amount of revenue we have previously recognized under those contracts. Backlog includes all contract options that have been priced but not yet funded. Backlog also includes the contract value under single award indefinite delivery, indefinite quantity, or ID/IQ, contracts against which we expect future task orders to be issued without competition. Backlog does not take contract ceiling value into consideration under multiple award contracts, nor does it include any estimate of future potential delivery orders that might be awarded under multiple award ID/IQ vehicles, government-wide acquisition contracts, or GWACs, or General Services Administration, or GSA, schedule contracts. We define funded backlog to be the portion of backlog for which funding currently is appropriated and obligated to us under a contract or other authorization for payment signed by an authorized purchasing authority.

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

***Days Sales Outstanding***

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

***Direct Labor Utilization***

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

***Organic Growth***

We calculate organic growth by comparing our actual reported revenue in the current period, including revenue attributable to acquired companies, with adjusted revenue from the prior-year period. In arriving at prior-year revenue, we include the revenue of acquired companies for the prior-year periods comparable to the current-year periods for which the acquired companies are included in our actual reported revenue. The resulting growth rate is intended to represent our organic, or non-acquisitive, growth year-over-year, including comparable period growth attributable to acquired companies. For illustrative purposes, we compute our fiscal 2007 organic growth rate of 3.4% as follows:

	Year Ended June 30,		
	2007	2006	% Increase
Revenue, as reported	\$ 1,268,872	\$ 1,179,267	7.6%
Plus: Revenue from acquired companies for the comparable prior year period		48,022	
Organic Revenue	\$ 1,268,872	\$ 1,227,289	3.4%

## **Table of Contents**

### **Recent Accounting Pronouncements**

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

During September 2006 the Securities and Exchange Commission released Staff Accounting Bulletin, or SAB No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. SAB No. 108 requires a registrant to quantify all misstatements that could be material to financial statement users under both the rollover and iron curtain approaches. If either approach results in quantifying a misstatement that is material the registrant must adjust its financial statements. SAB No. 108 is applicable for our fiscal year ended June 30, 2007. Our adoption of SAB No. 108 did not have a material impact on our consolidated financial statements.

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

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

### **Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

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

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

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

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

As of June 30, 2007 and 2006, the carrying value of financial instruments approximated fair value. These investments primarily consist of corporate and municipal bonds with maturities of 4 months or less that are classified as held-to-maturity.

**Table of Contents**

**Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The consolidated financial statements of SRA International, Inc. and subsidiaries are submitted on pages F-1 through F-23 of this report.

**Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**Item 9A. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of June 30, 2007. Based on this evaluation, our chief executive officer and chief financial officer concluded that, as of June 30, 2007, our disclosure controls and procedures were effective at the reasonable assurance level.

No change in our internal control over financial reporting occurred during the fiscal quarter ended June 30, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

The certifications of our chief executive officer and chief financial officer required under Section 302 of the Sarbanes-Oxley Act have been filed as Exhibits 31.1 and 31.2 to this report. Additionally, in 2006, our Chief Executive Officer certified to the New York Stock Exchange (NYSE) that he was not aware of any violation by the company of the New York Stock Exchange corporate governance listing standards.

---

**Table of Contents**

**MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The management of SRA International, Inc. and subsidiaries (the Company) is responsible for establishing and maintaining adequate internal control over financial reporting, as that term is defined in Exchange Act Rule 13a-15(f), and for assessing the effectiveness of internal control over financial reporting. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability and fair presentation of published financial statements in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of management, including our chief executive officer and chief financial officer, management assessed the effectiveness of the Company's internal control over financial reporting as of June 30, 2007 using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control - Integrated Framework*. This assessment excluded the internal control over financial reporting at RABA Technologies, LLC which was acquired on October 26, 2006 and whose financial statements reflect eight percent and one percent of net and total assets, respectively, three percent of revenue and six percent of net income of the related consolidated financial statement amounts as of and for the year ended June 30, 2007. Based on this assessment, management determined that the Company's internal control over financial reporting was effective as of June 30, 2007.

Deloitte & Touche LLP (D&T), an independent registered public accounting firm, has issued an attestation report on management's assessment of the Company's internal control over financial reporting. The D&T report immediately follows this report.

/s/ STANTON D. SLOANE  
**President and Chief Executive Officer**

/s/ STEPHEN C. HUGHES  
**Chief Financial Officer and Executive Vice President  
Operations**



---

**Table of Contents**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON  
INTERNAL CONTROL OVER FINANCIAL REPORTING**

To the Board of Directors and Stockholders of SRA International, Inc. and Subsidiaries

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that SRA International, Inc. and subsidiaries (the Company) maintained effective internal control over financial reporting as of June 30, 2007, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). As described in Management's Report on Internal Control Over Financial Reporting, management excluded from its assessment the internal control over financial reporting at RABA Technologies LLC., which was acquired on October 26, 2006 and whose financial statements constitute eight percent and one percent of net and total assets, respectively, three percent of revenue, and six percent of net income of the consolidated financial statements as of and for the year ended June 30, 2007. Accordingly, our audit did not include the internal control over financial reporting at RABA Technologies LLC. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of June 30, 2007, is fairly stated, in all material respects, based on the criteria established in *Internal Control - Integrated Framework* issued by COSO. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2007, based on the criteria established in *Internal Control - Integrated Framework* issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule as of and for the year ended June 30, 2007 of the Company and our report dated August 10, 2007 expressed an unqualified opinion on those financial statements and financial statement schedule.

/s/ DELOITTE & TOUCHE LLP

McLean, VA

August 10, 2007



**Table of Contents**

**Item 9B. OTHER INFORMATION**

None.

[REMAINDER OF PAGE LEFT BLANK INTENTIONALLY]

**Table of Contents**

**PART III**

**Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information required to be set forth herein is contained under the heading Executive Officers of the Registrant in Part I of this report. Other information required by this Item will be included under the headings Proposal 1 Election of Directors, Corporate Governance and Section 16(a) Beneficial Ownership reporting Compliance in the definitive proxy statement for our 2007 annual meeting of stockholders, or the 2007 proxy statement, which sections are incorporated herein by reference.

**Item 11. EXECUTIVE COMPENSATION**

The information required by this Item will be included under the headings Director Compensation, Executive Compensation, Compensation Committee Report on Executive Compensation, and Compensation Committee Interlocks and Insider Participation, in the 2007 proxy statement, which sections are incorporated herein by reference.

**Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by this Item will be included under the headings Beneficial Ownership of Common Stock and Equity Compensation Plan Information in the 2007 proxy statement, which sections are incorporated herein by reference.

**Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information required by this Item will be included under the heading Certain Relationships and Related Transactions in the 2007 proxy statement, which section is incorporated herein by reference.

**Item 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information required by this Item will be included under the heading Proposal 2 Ratification of Selection of Independent Auditors in the 2007 proxy statement, which section is incorporated herein by reference.

**Table of Contents****PART IV****Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

(a) Documents filed as part of the report:

(1) Consolidated Financial Statements

	<b>Page</b>
Report of Independent Registered Public Accounting Firm on the Consolidated Financial Statements	F-1
Consolidated Balance Sheets	F-2
Consolidated Statements of Operations	F-4
Consolidated Statements of Changes in Stockholders' Equity	F-5
Consolidated Statements of Cash Flows	F-6
Notes to Consolidated Financial Statements	F-7

(2) Financial Statement Schedule

Schedule II Valuation and Qualifying Accounts for the three years ended June 30, 2007	F-23
---	------

All other schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions or are inapplicable, and therefore have been omitted.

(3) Exhibits

<b>Exhibit Number</b>	<b>Description</b>
2.1	Agreement and Plan of Merger, by and among SRA International, Inc., Alex Acquisition Corporation, and Adroit Systems, Inc., dated January 3, 2003. Pursuant to Item 601(b)(2) of Regulation S-K, the exhibits and schedules of the Agreement and Plan of Merger are omitted.
2.2	Equity Purchase Agreement dated June 20, 2007 and Closing Agreement dated August 9, 2007, by and among SRA International, Inc., Systems Research Applications Corporation, Constella Group, LLC, and Donald A. Holzworth, as Seller Representative and certain identified shareholders of Constella. Pursuant to Item 601(b)(2) of Regulation S-K, the exhibits and schedules of the Equity Purchase Agreement and Closing Agreement are omitted.
3.1	Amended and Restated Certificate of Incorporation of the Registrant
3.2	Amended and Restated By-Laws of the Registrant
4.1	Specimen common stock certificate
4.2	See Exhibits 3.1 and 3.2 for provisions of the Certificate of Incorporation and By-Laws of the Registrant defining the rights of holders of common stock of the Registrant
10.1	1994 Stock Option Plan, as amended*
10.2	1985 Key Employee Incentive Plan*
10.3	2002 Stock Incentive Plan*

## Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

- 10.4 Deferred Compensation Plan for Key Employees, as amended\*
- 10.5 Office Lease Agreement, dated May 11, 1999, between the Registrant and Fair Lakes North and South L.P., as amended
- 10.6 Office Lease Agreement, dated May 11, 1999, between the Registrant and Fair Lakes North and South L.P., as amended
- 10.8 401(k) Savings Plan, as amended and restated effective January 1, 2001\*
- 10.8a^ Amendment to 401(k) Savings Plan\*
- 10.11 Stockholders Agreement among the Registrant, General Atlantic Partners 75, L.P., GAP Coinvestment Partners II, L.P., GapStar, LLC, GAPCO GmbH & Co. KG and the stockholders named therein, dated April 23, 2002
- 10.12 Registration Rights Agreement among the Registrant, General Atlantic Partners 75, L.P., GAP Coinvestment Partners II, L.P., GapStar, LLC, and GAPCO GmbH & Co. KG and the stockholders named therein, dated April 23, 2002

## **Table of Contents**

<b>Exhibit Number</b>	<b>Description</b>
10.13	Stock Purchase Agreement among the Registrant, General Atlantic Partners 75, L.P., GAP Coinvestment Partners II, L.P., GapStar, LLC, GAPCO GmbH & Co. KG and the stockholders named therein, dated April 22, 2002
10.14	Employment Agreement dated April 18, 2007 between SRA International, Inc. and Stanton D. Sloane
21.1	Subsidiaries of the Registrant
23.1	Consent of Independent Registered Public Accounting Firm
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
32.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Previously filed and incorporated by reference to the Registrant's Registration Statement on Form S-1 filed on May 21, 2002 (333-83780).

Incorporated by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended June 30, 2002 (File No. 001-31334).

Incorporated by reference to the Registrant's Current Report on Form 8-K filed with the SEC on February 13, 2002 (File No. 001-31334).

Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2007. (File No. 001-31334).

^ Incorporated by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended June 30, 2003 (File No. 001-31334).

\* Management contract or compensatory plan, contract or arrangement.

**Table of Contents****SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the city of Fairfax, Virginia on the 15th day of August, 2007.

**SRA INTERNATIONAL, INC.**

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

**President and Chief Executive Officer**

**(Principal Executive Officer)**

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<b>Signature</b>	<b>Title</b>	<b>Date</b>
/s/ STANTON D. SLOANE  Stanton D. Sloane	President and Chief Executive Officer (Principal Executive Officer)	August 15, 2007
/s/ STEPHEN C. HUGHES  Stephen C. Hughes	Chief Financial Officer and Executive Vice President Operations (Principal Financial and Accounting Officer)	August 15, 2007
  Ernst Volgenau	Chairman	
/s/ JOHN W. BARTER  John W. Barter	Director	August 15, 2007
/s/ RENATO A. DiPENTIMA  Renato A. DiPentima	Director	August 15, 2007
/s/ LARRY R. ELLIS  Larry R. Ellis	Director	August 15, 2007
/s/ MILES R. GILBURNE  Miles R. Gilburne	Director	August 15, 2007
/s/ MICHAEL R. KLEIN  Michael R. Klein	Director	August 15, 2007
  David H. Langstaff	Director	



Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

**Delbert C. Staley**

/s/ GAIL R. WILENSKY

Director

August 15, 2007

**Gail R. Wilensky**

**Table of Contents**

**SRA INTERNATIONAL, INC. AND SUBSIDIARIES**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON THE  
CONSOLIDATED FINANCIAL STATEMENTS**

To the Board of Directors and Stockholders of SRA International, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of SRA International, Inc. and subsidiaries (the Company) as of June 30, 2007 and 2006, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the three years in the period ended June 30, 2007. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2). These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of SRA International, Inc. and subsidiaries as of June 30, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2007, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of June 30, 2007, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated August 10, 2007 expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP

McLean, Virginia

August 10, 2007

**Table of Contents****SRA INTERNATIONAL, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****(in thousands)****Assets**

	<b>June 30,</b>	
	<b>2007</b>	<b>2006</b>
Current assets:		
Cash and cash equivalents	\$ 212,034	\$ 173,564
Short-term investments	85	9,834
Accounts receivable, net	262,409	268,908
Prepaid expenses and other	26,285	23,382
Deferred income taxes, current	5,860	4,839
Total current assets	506,673	480,527
Property and equipment, net	36,685	37,462
Other assets:		
Goodwill	256,530	169,334
Identified intangibles, net	30,849	26,169
Deferred income taxes, noncurrent	8,163	3,462
Deferred compensation trust	8,784	7,768
Total other assets	304,326	206,733
Total assets	\$ 847,684	\$ 724,722

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

**Table of Contents****SRA INTERNATIONAL, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****(in thousands, except share and per share amounts)****Liabilities and Stockholders' Equity**

	<b>June 30,</b>	
	<b>2007</b>	<b>2006</b>
<b>Current liabilities:</b>		
Accounts payable and accrued expenses	\$ 110,897	\$ 115,545
Accrued payroll and employee benefits	81,711	59,463
Billings in excess of revenue recognized	16,980	5,952
<b>Total current liabilities</b>	<b>209,588</b>	<b>180,960</b>
<b>Long-term liabilities:</b>		
Other long-term liabilities	12,641	10,465
<b>Total long-term liabilities</b>	<b>12,641</b>	<b>10,465</b>
<b>Total liabilities</b>	<b>222,229</b>	<b>191,425</b>
<b>Commitments and contingencies</b>		
<b>Stockholders' equity:</b>		
Preferred stock, par value \$0.20 per share; 5,000,000 shares authorized; none issued		
Class A common stock, par value \$0.004 per share; 180,000,000 shares authorized; 43,576,434 and 42,158,048 shares issued as of June 30, 2007 and 2006; 42,865,008 and 41,403,312 shares outstanding as of June 30, 2007 and 2006	174	169
Class B common stock, par value \$0.004 per share; 55,000,000 shares authorized; 14,199,828 and 14,459,828 shares issued and outstanding as of June 30, 2007 and 2006	57	58
Additional paid-in capital	302,970	274,552
Treasury stock, at cost	(5,996)	(6,302)
Retained earnings	328,250	264,820
<b>Total stockholders' equity</b>	<b>625,455</b>	<b>533,297</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 847,684</b>	<b>\$ 724,722</b>

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

**Table of Contents****SRA INTERNATIONAL, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS****(in thousands, except share and per share amounts)**

	Year Ended June 30,		
	2007	2006	2005
Revenue	\$ 1,268,872	\$ 1,179,267	\$ 881,770
Operating costs and expenses:			
Cost of services	954,656	880,802	653,115
Selling, general and administrative	200,204	183,297	126,404
Depreciation and amortization	21,187	18,201	13,141
Total operating costs and expenses	1,176,047	1,082,300	792,660
Operating income	92,825	96,967	89,110
Interest income, net	6,276	4,232	3,442
Gain on sale of Mantas, Inc.	3,674		
Income before taxes	102,775	101,199	92,552
Provision for income taxes	39,345	38,679	34,829
Net income	\$ 63,430	\$ 62,520	\$ 57,723
Earnings per share:			
Basic	\$ 1.12	\$ 1.14	\$ 1.09
Diluted	\$ 1.09	\$ 1.08	\$ 1.02
Weighted-average shares:			
Basic	56,476,927	55,064,138	52,965,623
Diluted	58,381,788	57,738,875	56,549,303

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

**Table of Contents****SRA INTERNATIONAL, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**

(in thousands, except share amounts)

	Class A		Class B		Additional Paid-In	Treasury Stock		Deferred Stock-Based	Retained	
	Common Stock Shares	Amount	Common Stock Shares	Amount	Capital	Shares	Amount	Compensation	Earnings	Total
Balance, July 1, 2004	47,177,442	\$ 194	20,374,410	\$ 78	\$ 241,695	(15,776,376)	\$ (46,560)	\$ (716)	\$ 144,577	\$ 339,268
Net income									57,723	57,723
Issuance of common stock (a)	2,134,537	9			10,128			56		10,193
Reissuance of treasury stock					4,030	122,530	405			4,435
Adjustment due to stock split	(10,937,171)	(49)	(3,882,352)	(12)	(41,255)	14,834,323	41,316			
Tax benefits of stock option exercises					17,156					17,156
Shares converted between classes	864,592	3	(864,592)	(3)						
Compensatory stock options issued or modified								240		240
Amortization of deferred stock-based compensation								77		77
Balance, June 30, 2005	39,239,400	157	15,627,466	63	231,754	(819,523)	(4,839)	(343)	202,300	429,092
Net income									62,520	62,520
Issuance of common stock (a)	1,751,010	7			13,911			(919)		12,999
Reissuance of treasury stock					3,198	134,162	799			3,997
Purchase of treasury stock						(69,375)	(2,262)			(2,262)
Tax benefits of stock option exercises					13,774					13,774
Shares converted between classes	1,167,638	5	(1,167,638)	(5)						
FAS 123(R) stock based compensation					12,803					12,803
Amortization of deferred stock-based compensation								374		374
Balance, June 30, 2006	42,158,048	169	14,459,828	58	275,440	(754,736)	(6,302)	(888)	264,820	533,297
Net income									63,430	63,430
Issuance of common stock (a)	1,158,386	4			8,872			674		9,550
Reissuance of treasury stock					855	46,392	390			1,245
Purchase of treasury stock						(3,082)	(84)			(84)
Tax benefits of stock option exercises					6,521					6,521
Shares converted between classes	260,000	1	(260,000)	(1)						
FAS 123(R) stock based compensation					11,282					11,282
Amortization of deferred stock-based compensation								214		214
Balance, June 30, 2007	43,576,434	\$ 174	14,199,828	\$ 57	\$ 302,970	(711,426)	\$ (5,996)	\$	\$ 328,250	\$ 625,455

(a) Relates to the exercise of stock options, vesting of restricted stock, and the issuance of common stock for the ESPP.  
The accompanying notes are an integral part of these consolidated financial statements.



**Table of Contents****SRA INTERNATIONAL, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands)**

	<b>Year Ended June 30,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Cash flows from operating activities:			
Net income	\$ 63,430	\$ 62,520	\$ 57,723
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	21,187	18,201	13,141
Stock-based compensation	11,496	13,177	317
Tax benefits of stock option exercises			17,156
Deferred income taxes	(5,722)	(1,901)	(3,570)
Gain on sale of Mantas, Inc.	(3,674)		
Changes in assets and liabilities, net of the effect of acquisitions:			
Accounts receivable	17,425	(41,822)	(39,172)
Prepaid expenses and other	(2,667)	2,250	2,941
Accounts payable and accrued expenses	(8,991)	32,609	7,704
Accrued payroll and employee benefits	17,385	2,534	8,226
Billings in excess of revenue recognized	11,028	(664)	1,622
Other	1,547	(73)	(100)
Net cash provided by operating activities	122,444	86,831	65,988
Cash flows from investing activities:			
Capital expenditures	(12,624)	(15,639)	(21,353)
Purchases of investments		(9,748)	(18,516)
Sales and maturities of investments	9,749	25,723	15,983
Acquisition of Touchstone Consulting Group, net of cash acquired			(37,124)
Acquisition of Galaxy Scientific Corporation, net of cash acquired		(95,645)	
Acquisition of Spectrum Solutions Group, net of cash acquired	(8,000)	(8,802)	
Acquisition of Mercomms Unlimited, net of cash acquired		(637)	
Acquisition of RABA Technologies, net of cash acquired	(94,005)		
Proceeds from sale of Mantas, Inc.	3,674		
Net cash used in investing activities	(101,206)	(104,748)	(61,010)
Cash flows from financing activities:			
Issuance of common stock	9,550	12,999	10,193
Tax benefits of stock option exercises	6,521	13,774	
Reissuance of treasury stock	1,245	3,997	4,435
Purchase of treasury stock	(84)	(2,262)	
Net cash provided by financing activities	17,232	28,508	14,628
Net increase in cash and cash equivalents	38,470	10,591	19,606
Cash and cash equivalents, beginning of period	173,564	162,973	143,367
Cash and cash equivalents, end of period	\$ 212,034	\$ 173,564	\$ 162,973

## Supplemental disclosures of cash flow information:

Cash paid during the period:



# Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

Income taxes	\$ 38,012	\$ 26,377	\$ 21,211
Cash received during the period:			
Interest	\$ 6,103	\$ 4,219	\$ 3,897
Income taxes	\$ 938	\$ 1,038	\$ 652

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

F-6

---

**Table of Contents**

**SRA INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Years Ended June 30, 2007, 2006, and 2005**

**1. Summary of Significant Accounting Policies:**

**Principles of Consolidation**

The accompanying consolidated financial statements include the accounts of SRA International, Inc. (a Delaware corporation), and its wholly-owned subsidiaries (SRA or the Company). All intercompany transactions and balances have been eliminated.

**Nature of Business**

SRA provides technology and strategic consulting services and solutions primarily to clients in national security, civil government, and health care and public health. Since SRA's founding in 1978, the Company has derived substantially all of its revenue from services provided to federal government clients.

Revenue from contracts with federal government agencies was 99 percent of total revenue for all periods presented herein. The National Guard, as a client group, accounted for approximately 10 percent, and 11 percent of revenue for the years ended June 30, 2006, and 2005, respectively. The United States Agency for International Development, as a client, accounted for approximately 10 percent, and 12 percent of revenue for the years ended June 30, 2006, and 2005, respectively. No other client or client group accounted for more than 10 percent of revenue in the periods presented herein.

**Accounting Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and judgments in determining the reported amounts of assets, liabilities, revenue and expenses, as well as the disclosure of contingent assets and liabilities. On an ongoing basis, the Company evaluates its estimates, including those related to revenue recognition, doubtful accounts receivable, goodwill and other intangible assets, and other contingent liabilities. The Company bases its estimates on historical experience and various other factors that are deemed reasonable at the time the estimates are made. Actual results may differ from estimates under different assumptions or conditions. See the Revenue Recognition section of this Note and Notes 2, 5, 10, and 11 for additional information on certain estimates included in the Company's consolidated financial statements.

**Revenue Recognition**

***Contract Accounting***

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

Absent evidence to the contrary, the Company recognizes revenue as follows. Revenue on cost-plus-fee contracts is recognized to the extent of costs actually incurred plus a proportionate amount of the fee earned. The Company considers fixed fees under cost-plus-fee contracts to be earned in proportion to the allowable costs actually incurred in performance of the contract. Revenue on time-and-materials contracts is recognized based on the hours actually incurred at the negotiated contract billing rates, plus the cost of any allowable material costs and out-of-pocket expenses. Revenue on fixed-price contracts where the Company performs systems design, development and integration is recognized using the percentage-of-completion method of contract accounting. Unless it is determined as part of the Company's regular contract performance review that overall progress on a contract is not consistent with costs expended to date, the Company determines the percentage completed based on the percentage of costs incurred to date in relation to total estimated costs expected upon completion of the contract. Revenue on fixed-price outsourcing and managed services contracts is generally recognized ratably over the contract period. Revenue on

## Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

fixed-price strategic consulting contracts is generally recognized based on costs incurred because these services are directed by the Company's customers and are subject to their needs which fluctuate throughout the contract period. The Company considers performance-based fees, including award fees, under any contract type to be earned when it can demonstrate satisfaction of performance goals, based upon historical experience, or the

F-7

**Table of Contents**

Company receives contractual notification from a client that the fee has been earned. Billings for hardware or software purchased by customers under one of the Company's contracts where we act as an agent to the transaction are excluded from the Company's revenue and cost of services, except to the extent of any handling fee or profit earned.

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

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

The Company maintains reserves for doubtful accounts receivable that may arise in the normal course of business. This allowance for doubtful accounts is based on several factors, including the customer's payment history, the age of the accounts receivable, and management's judgment regarding the likelihood of collection. Historically, the Company has not had significant write-offs of doubtful accounts receivable related to work performed for the federal government. However, the Company does perform work on contracts and task orders where, on occasion, issues arise that lead to accounts receivable not being collected.

Revenue for the years ended June 30, 2007, 2006, and 2005 was earned from the following contract types:

	2007	2006	2005
Cost-plus-fee	43%	45%	46%
Time-and-materials	42	40	34
Fixed-price	15	15	20

***Software Licensing and Related Activities***

The Company enters into arrangements, which may include the sale of licenses of the Company's proprietary software, consulting services and maintenance, or various combinations of each element. The Company recognizes revenue based on Statement of Position (SOP) 97-2, Software Revenue Recognition, as amended, and modified by SOP 98-9, Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions. SOP 98-9 modified SOP 97-2 by requiring revenue to be recognized using the residual method if certain conditions are met. Revenue is recognized based on the residual method when an agreement has been signed by both parties, the fees are fixed or determinable, collection of the fees is probable, delivery of the product has occurred, and no other significant obligations remain. In the limited cases where return or refund rights have been offered, the Company defers all revenue recognition until the end of the return or refund period. Total software licensing and related activities revenue was \$5,368,000, \$3,961,000, and \$4,148,000 for the years ended June 30, 2007, 2006, and 2005, respectively. Software licensing of the Company's proprietary software and related activities revenue was less than one percent of consolidated revenue for all periods presented.

**Research and Development Costs**

Research and development costs are expensed as incurred. Total research and development costs, which are included in selling, general and administrative expenses, were \$1,215,000, \$1,290,000, and \$1,638,000 for the years ended June 30, 2007, 2006, and 2005, respectively.

**Internal-Use Computer Software**

The Company capitalizes costs incurred to license and implement software for internal-use in accordance with SOP 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal-Use. Such costs are amortized over periods ranging from three to seven years. Internal-use software costs capitalized were \$213,000, \$638,000, and \$2,813,000 for the years ended June 30, 2007, 2006, and 2005, respectively.



## **Table of Contents**

### **Impairment of Long-Lived Assets**

Whenever events or changes in circumstances indicate that the carrying amount of long-lived assets and other intangibles may not be fully recoverable, the Company evaluates the probability that future undiscounted net cash flows, without interest charges, will be less than the carrying amount of the assets. If an impairment is indicated as a result of this review, the Company recognizes a loss based on the amount by which the carrying amount exceeds the estimated discounted future cash flows.

### **Income Taxes**

The Company utilizes the asset and liability method of accounting for income taxes. Under this method, deferred income taxes are recognized for the tax consequences of temporary differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities less valuation allowances, if required. Enacted statutory tax rates are used to compute the tax consequences of these temporary differences.

### **Deferred Compensation Plan**

Certain key employees of the Company are eligible to defer a specified percentage of their cash compensation by having it contributed to a nonqualified deferred compensation plan. Eligible employees may elect to defer up to 50 percent of their base salary and up to 100 percent of performance bonuses, reduced by any amounts withheld for the payment of taxes or other deductions required by law. The Company funds its deferred compensation liabilities by making cash contributions to a Rabbi Trust at the time the salary or bonus being deferred would otherwise be payable to the employee. Gains or losses on amounts held in the Rabbi Trust are fully allocable to plan participants. As a result, there is no net impact on the Company's results of operations, and the liability to plan participants is fully funded at all times.

### **Cash and Cash Equivalents**

The Company considers all highly liquid investments with a current maturity of 90 days or less to be cash equivalents.

### **Investments in Debt Securities**

The Company considers all investments with current maturity dates of one year or less that do not qualify as cash equivalents to be short-term investments. The Company does not purchase investments with original maturity dates that exceed two years. The Company classifies all investments in debt securities as held-to-maturity and accounts for these investments at amortized cost.

### **Property and Equipment**

Property and equipment, including major additions or improvements thereto, are recorded at cost and depreciated over their estimated useful lives ranging from three to seven years using the straight-line method. Leasehold improvements are amortized over the lesser of the lease term or the asset's estimated useful life, but typically not exceeding seven years, using the straight-line method. Depreciation and amortization expense related to property and equipment, including capitalized internal-use computer software, was \$14,428,000, \$13,205,000, and \$11,150,000 for the years ended June 30, 2007, 2006, and 2005, respectively.

### **Goodwill and Intangible Assets**

Goodwill, which represents the excess of the cost of an acquired entity over the net amounts assigned to assets acquired and liabilities assumed, is assessed for impairment under Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets" (Note 5). Intangible assets with finite lives are amortized on a straight-line basis over their useful lives, typically determined with the assistance of an outside valuation firm, of 5 to 12 years. Intangible assets are evaluated for impairment whenever events or changes in circumstances indicate that their carrying value may not be recoverable in accordance with SFAS No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets."

### **Concentration of Credit Risk and Fair Value of Financial Instruments**

Financial instruments that potentially subject the Company to credit risk consist primarily of cash equivalents, short- and long-term investments, and accounts receivable. The Company believes that concentrations of credit risk with respect to cash equivalents and investments are limited due to the high credit quality of these investments. The Company's investment policy requires that investments be in direct obligations of the

## Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

U.S. government, certain U.S. government sponsored entities, investments that are secured by direct or sponsored U.S. government obligations, or certain corporate or municipal debt obligations rated at least single-A or A-1/P-1, as applicable, by both Moody's Investor Service and Standard and Poor's. The

F-9

## **Table of Contents**

Company's policy does not allow investment in any equity securities or the obligations of any entity under review for possible downgrade by a major rating service to a debt rating below single-A.

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

The Company believes that concentrations of credit risk with respect to accounts receivable are limited as they are primarily federal government receivables.

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

## **Stock Split**

On May 2, 2005, the Company's board of directors declared a two-for-one split of the Company's outstanding common stock in the form of a 100 percent stock dividend. The stock dividend was distributed on May 27, 2005 to stockholders of record on May 13, 2005.

The par value of the Company's common stock was not adjusted with the stock split and remains at \$0.004 per share. As a result, the Company reclassified amounts from additional paid-in capital to class A and class B par value of common stock based on the total shares of common stock issued. The Company used treasury shares to satisfy a portion of the stock dividend. The issuance of treasury shares was accounted for by transferring the book value of those shares from treasury stock to additional paid-in capital.

All per share amounts, outstanding shares of common stock, and common stock equivalents reported in the accompanying consolidated financial statements and notes thereto have been adjusted to retroactively reflect the stock split.

## **Earnings Per Share**

The Company calculates basic and diluted earnings per share (EPS) in accordance with SFAS No. 128, Earnings Per Share. Basic EPS is computed by dividing reported net income by the basic weighted-average number of common shares outstanding. Diluted EPS considers the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. The difference between basic and diluted weighted-average common equivalent shares with respect to the Company's EPS calculation is due to the effect of potential future exercises of stock options and vesting of restricted stock shares.

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

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

Undistributed earnings are calculated as follows (in thousands):

Year Ended		
	June 30,	
2007	2006	2005



# Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

Net income	\$ 63,430	\$ 62,520	\$ 57,723
Less: dividends			
Undistributed earnings	\$ 63,430	\$ 62,520	\$ 57,723

F-10

**Table of Contents**

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

	Year Ended					
	2007		June 30, 2006		2005	
	Class A	Class B	Class A	Class B	Class A	Class B
Basic weighted-average common shares outstanding	42,151	14,326	40,270	14,794	36,937	16,028
Assumed conversion of class B shares	14,326		14,794		16,028	
Effect of potential exercise or vesting of stock-based awards	1,905		2,675		3,584	
Diluted weighted-average common shares outstanding	58,382	14,326	57,739	14,794	56,549	16,028

Stock options that were not included in the computation of diluted weighted-average common shares outstanding, because to do so would have been antidilutive were 1,749,771, 1,490,708, and 375,000 for the years ended June 30, 2007, 2006, and 2005, respectively.

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

	Year Ended					
	2007		June 30, 2006		2005	
	Class A	Class B	Class A	Class B	Class A	Class B
<b>Basic</b>						
Weighted-average shares outstanding	42,151	14,326	40,270	14,794	36,937	16,028
Divided by: Total weighted-average shares outstanding						
(class A and class B)	56,477	56,477	55,064	55,064	52,966	52,966
Multiplied by: Undistributed earnings	\$ 63,430	\$ 63,430	\$ 62,520	\$ 62,520	\$ 57,723	\$ 57,723
Subtotal	\$ 47,340	\$ 16,090	\$ 45,723	\$ 16,797	\$ 40,255	\$ 17,468
Divided by: Weighted-average shares outstanding	42,151	14,326	40,270	14,794	36,937	16,028
Earnings per share	\$ 1.12	\$ 1.12	\$ 1.14	\$ 1.14	\$ 1.09	\$ 1.09
<b>Diluted</b>						
Weighted-average shares outstanding	58,382	14,326	57,739	14,794	56,549	16,028
Divided by: Total weighted-average shares outstanding						
(class A and class B)	58,382	58,382	57,739	57,739	56,549	56,549
Multiplied by: Undistributed earnings	\$ 63,430	\$ 63,430	\$ 62,520	\$ 62,520	\$ 57,723	\$ 57,723
Subtotal	\$ 63,430	\$ 15,565	\$ 62,520	\$ 16,019	\$ 57,723	\$ 16,361
Divided by: Weighted-average shares outstanding	58,382	14,326	57,739	14,794	56,549	16,028
Earnings per share	\$ 1.09	\$ 1.09	\$ 1.08	\$ 1.08	\$ 1.02	\$ 1.02

**Recent Accounting Pronouncements**

## Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

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

F-11

**Table of Contents**

In September 2006, the Securities and Exchange Commission released Staff Accounting Bulletin (SAB) No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. SAB No. 108 requires a registrant to quantify all misstatements that could be material to financial statement users under both the rollover and iron curtain approaches. If either approach results in quantifying a misstatement that is material the registrant must adjust its financial statements. SAB No. 108 is applicable for the Company's fiscal year ended June 30, 2007. The adoption of SAB No. 108 did not have a material impact on the Company's consolidated financial statements.

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

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

**Reclassifications**

Certain reclassifications have been made to prior-period balances to conform to the current-period presentation, including the reclassification of prepaid software licenses and maintenance on cost-plus-fee and time-and-materials contracts from accounts receivable to billings in excess of revenue recognized.

**2. Accounts Receivable:**

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

	2007	2006
Billed and billable, net of allowance of \$2,689 and \$1,614 as of June 30, 2007 and 2006, respectively	\$ 240,735	\$ 245,007
Unbilled:		
Retainages	4,508	5,347
Revenue recorded in excess of milestone billings on fixed-price contracts	11,585	7,210
Revenue recorded in excess of contractual authorization, billable upon receipt of contractual amendments/documents	7,188	13,079
Allowance for unbillable amounts	(1,607)	(1,735)
Total unbilled	21,674	23,901
Total accounts receivable	\$ 262,409	\$ 268,908

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

Consistent with industry practice, certain receivables related to long-term contracts are classified as current, although a portion of these amounts is not expected to be billed and collected within one year. Unbilled accounts receivable at June 30, 2007 are expected to be billed and collected within one year except for approximately \$1.5 million related to a portion of retainages.

**3. Prepaid Expenses and Other:**

Prepaid expenses and other as of June 30, 2007 and 2006 consisted of the following (in thousands):

F-12

**Table of Contents**

	2007	2006
Hardware and equipment purchased on behalf of customers	\$ 1,706	\$ 10,468
Prepaid maintenance and software	17,610	7,385
Other	6,969	5,529
Total prepaid expenses and other	\$ 26,285	\$ 23,382

**4. Property and Equipment:**

The components of property and equipment as of June 30, 2007 and 2006 are as follows (in thousands):

	2007	2006
Leasehold improvements	\$ 25,853	\$ 24,653
Furniture, equipment, and software	65,636	59,387
Subtotal	91,489	84,040
Less: Accumulated depreciation and amortization	(54,804)	(46,578)
Total property and equipment, net	\$ 36,685	\$ 37,462

**5. Goodwill and Identified Intangibles:**

The components of goodwill and identified intangible assets as of June 30, 2007 and 2006 are as follows (in thousands):

	2007	2006
Goodwill	\$ 256,530	\$ 169,334
Identified intangibles	46,704	35,265
Subtotal	303,234	204,599
Less: Accumulated amortization	(15,855)	(9,096)
Total goodwill and identified intangibles	\$ 287,379	\$ 195,503

Goodwill must be reviewed annually for impairment. The Company performs this review at the beginning of each calendar year. The Company performed the annual goodwill impairment analysis as of January 1, 2007 and concluded that there was no impairment of goodwill. Amortization expense of identified intangibles was \$6,759,000, \$4,996,000, and \$1,991,000 for the years ended June 30, 2007, 2006, and 2005, respectively. Identified intangibles are being amortized on a straight-line basis over a period of 5 to 12 years.

The changes in the carrying amount of goodwill were as follows (in thousands):

Balance as of July 1, 2005	89,214
Acquisitions of Galaxy and Spectrum	80,120
Balance as of June 30, 2006	169,334
Acquisitions of RABA and Spectrum	87,196
Balance as of June 30, 2007	\$ 256,530

## Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

Estimated amortization expense is as follows for the periods indicated (in thousands):

Years ending June 30,	
2008	\$ 7,533
2009	6,983
2010	6,206
2011	4,845
2012	2,199
Thereafter	3,083
Total	\$ 30,849

### 6. Accounts Payable and Accrued Expenses:

Accounts payable and accrued expenses as of June 30, 2007 and 2006 consisted of the following (in thousands):

F-13

**Table of Contents**

	2007	2006
Vendor obligations	\$ 101,877	\$ 108,803
Current taxes payable and other	9,020	6,742
Total accounts payable and accrued expenses	\$ 110,897	\$ 115,545

**7. Accrued Payroll and Employee Benefits:**

Accrued payroll and employee benefits as of June 30, 2007 and 2006 consisted of the following (in thousands):

	2007	2006
Accrued salaries and incentive compensation	\$ 35,018	\$ 17,714
Accrued leave	32,334	27,858
Accrued fringe benefits	14,359	13,891
Total accrued payroll and employee benefits	\$ 81,711	\$ 59,463

**8. Other Long-Term Liabilities:**

Other long-term liabilities as of June 30, 2007 and 2006 consisted of the following (in thousands):

	2007	2006
Liability to deferred compensation plan participants	\$ 8,784	\$ 7,768
Incentives for tenant improvements and other	3,857	2,697
Total other long-term liabilities	\$ 12,641	\$ 10,465

**9. Benefit Plan:**

The Company maintains a defined contribution plan, the SRA International, Inc. 401(k) Savings Plan (Plan). All regular and full-time employees are generally eligible to participate in the Plan. The board of directors of SRA may elect to make matching or other discretionary contributions to the Plan. The Company's matching contribution expense was \$12,484,000, \$10,026,000, and \$7,477,000 for the years ended June 30, 2007, 2006, and 2005, respectively, including the value of the stock described in the next paragraph.

Plan participants may elect to receive matching contributions in cash, company stock, or a combination of the two. Matching contributions are earned by participants on the basis of their calendar year contributions to the Plan. The Company makes the matching contributions, including the transfer of class A common stock, each January for participant contributions made during the previous calendar year. The Company contributed 46,392, 56,142, and 107,730 shares of class A common stock to the Plan during the years ended June 30, 2007, 2006, and 2005, respectively.

**10. Stockholders' Equity and Stock Options:****Preferred Stock**

The Company is authorized to issue 5,000,000 shares of preferred stock, \$0.20 par value per share, the terms and conditions of which are determined by the board of directors at each issuance. No preferred stock has been issued.

**Common Stock**



## Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

Holders of class A common stock are entitled to dividends per share in an amount equal to dividends per share declared and paid on class B common stock. Holders of both classes of common stock vote as a single class, with each share of class A common stock having one vote per share and each share of class B common stock having ten votes per share. Holders of both classes of common stock would share ratably in the net assets of the Company upon its liquidation or dissolution.

F-14

## **Table of Contents**

### **Treasury Stock**

In limited circumstances, the Company may elect to repurchase shares of outstanding common stock from employees upon the exercise of stock options, or upon the vesting of restricted stock, for the purpose of satisfying the minimum required tax withholding.

Our Board of Directors has authorized the repurchase of up to \$40 million of the Company's class A common stock. The timing, price, quantity and manner of the purchases can be determined at the discretion of the Company's CEO. The Company has not repurchased any shares in accordance with this authorization.

### **Stock Options**

#### **Accounting for Stock-Based Compensation:**

##### ***Stock-Based Benefit Plans***

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

In March 2002, the Company adopted the SRA International, Inc. 2002 Stock Incentive Plan. Upon adoption, up to 7,058,822 shares of class A common stock were reserved for issuance under the 2002 plan. Pursuant to the terms of the 2002 plan, the number of shares authorized for issuance automatically increases at the beginning of each fiscal year, beginning with the fiscal year ended June 30, 2004. An additional 8,074,514 shares of class A common stock were reserved for issuance pursuant to the automatic increase feature of the 2002 plan through July 1, 2007. The 2002 plan provides for the grant of incentive stock options, non-statutory stock options, restricted stock, and other stock-based awards. The 2002 plan is administered by the compensation committee of the board of directors, which determines the number of shares covered by options, and the exercise price, vesting period, and duration of option grants. The board of directors also has the authority under the 2002 plan to determine the number of shares of common stock subject to any restricted stock or other stock-based awards and the terms and conditions of such awards. The 2002 plan expires in March 2012.

##### ***Adoption of SFAS No. 123R***

Effective July 1, 2005, the Company adopted SFAS No. 123 (revised 2004), Share-Based Payment, which requires that compensation costs related to share-based payment transactions be recognized in financial statements. The Company applied the modified prospective method under which compensation costs for all awards granted after the date of adoption and the unvested portion of previously granted awards outstanding at the date of adoption are measured at estimated fair value and included in operating expenses over the vesting period during which an employee provides service in exchange for the award. The Company's restricted stock awards are considered nonvested share awards as defined under SFAS No. 123R.

Prior to the adoption of SFAS No. 123R, the Company reported all tax benefits resulting from the exercise of stock options as operating cash flows in the consolidated statements of cash flows. In accordance with SFAS No. 123R, for the period beginning July 1, 2005, excess tax benefits from the exercise of stock options are presented as financing cash flows. The excess tax benefits totaled \$6.5 million and \$13.8 million for the years ended June 30, 2007 and 2006, respectively. Such benefits were \$17.2 million for the year ended June 30, 2005, and are presented as a component of operating cash flows.

Under the provisions of SFAS No. 123R, the Company recorded \$11.5 million and \$13.2 million of stock-based compensation expense in its statement of operations for the years ended June 30, 2007 and 2006, respectively. This stock-based compensation expense reduced both basic and diluted earnings per share by \$0.12 and \$0.14 for the years ended June 30, 2007 and 2006, respectively.

## **Table of Contents**

### ***Fair Value Determination***

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

The Company has 10-year and 15-year options. The following weighted-average assumptions were used for option grants during the years ended June 30, 2007, 2006 and 2005:

*Expected Volatility.* The expected volatility of the Company's shares was estimated based upon the historical volatility of the Company's share price. The expected volatility factor used in valuing options granted during the years ended June 30, 2007, 2006, and 2005 was 31 percent, 32 percent and 31 percent, respectively.

*Expected Term.* The expected term was estimated based upon exercise experience of option grants made in the past to Company employees. Historical experience shows that employees typically exercise options prior to the end of the contractual term. The expected term used in valuing options granted for all periods presented was 5 years.

*Risk-free Interest Rate.* The Company bases the risk-free interest rate used in the Black-Scholes-Merton valuation method on the implied yield available on a U.S. Treasury note with a term equal to the expected term of the underlying grants. The weighted-average risk-free interest rate used in valuing options granted during the years ended June 30, 2007, 2006 and 2005 was 4.7 percent, 4.2 percent, and 3.6 percent, respectively.

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

### ***Stock Compensation Expense***

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

The Company recorded \$11.5 million and \$13.2 million of stock-based compensation expense for the years ended June 30, 2007 and 2006, respectively. The lower stock-based compensation expense reflects adjustments to account for the forfeitures of certain share-based awards in excess of what was estimated at the time of grant.

As of June 30, 2007, there was \$23.8 million of total unrecognized compensation cost related to nonvested share-based compensation arrangements. This cost is expected to be fully amortized in four years, with half of the total amortization cost being recognized within the next 14 months.

### ***Stock Option Activity***

During the year ended June 30, 2007, the Company granted stock options to purchase 627,202 shares of class A common stock at a weighted-average exercise price of \$25.48 per share based on the fair value of class A common stock on the date of grant. The Black-Scholes-Merton weighted-average value of options granted for the years ended June 30, 2007, 2006, and 2005, was \$9.27, \$12.32, and \$7.80, respectively. Using the Black Scholes-Merton model, the total value of the options granted for the years ended June 30, 2007, 2006, and 2005, was \$5.2 million, \$18.1 million, and \$16.3 million respectively. The options vest at the rate of 25 percent per year over four years, beginning on the date of grant and expire ten years from the grant date.

The following table summarizes stock option activity for the year ended June 30, 2007:

Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

	<b>Number of Shares</b>	<b>Weighted- Average Exercise Price</b>	<b>Aggregate Intrinsic Value (in thousands)</b>
Shares under option, July 1, 2006	7,666,784	\$ 18.00	\$ 80,365
Options granted	627,202	25.48	\$
Options exercised	(1,137,725)	7.33	\$ 21,144
Options cancelled and expired	(537,464)	29.44	\$ 1,087
Shares under option, June 30, 2007	6,618,797	\$ 19.62	\$ 51,440
Options exercisable at June 30, 2007	3,983,695	\$ 14.83	\$ 45,846
Shares reserved for equity awards at June 30, 2007	6,268,751		

F-16

**Table of Contents**

Information with respect to stock options outstanding and stock options exercisable at June 30, 2007 was as follows:

		Weighted-Average	
Range of Exercise Price	Options Outstanding	Remaining Contractual Life	Weighted-Average Exercise Price
\$3.17 - \$5.07	1,209,458	6.8 years	\$ 4.12
\$10.85 - \$16.80	1,774,089	8.2	\$ 14.37
\$19.39 - \$25.81	2,037,180	7.6	\$ 22.10
\$26.09 - \$35.40	1,598,070	8.0	\$ 34.02
	6,618,797		

		Weighted-Average	
Range of Exercise Price	Options Exercisable	Remaining Contractual Life	Weighted-Average Exercise Price
\$3.17 - \$5.07	1,209,458	6.8 years	\$ 4.12
\$10.85 - \$16.80	1,512,103	8.5	\$ 14.00
\$19.39 - \$25.81	751,664	6.9	\$ 20.92
\$26.09 - \$35.40	510,470	7.6	\$ 33.69
	3,983,695		

During the years ended June 30, 2007 and 2006, the Company also granted 295,337 and 35,450 nonvested restricted shares at a weighted-average grant date fair market value of \$26.02 and \$30.06 per share, respectively. These shares vest at the rate of 25 percent per year over four years.

The following table summarizes restricted stock activity for the year ended June 30, 2007:

		Weighted-Average	
	Number of Shares	Grant-Date Value	
Nonvested restricted shares at July 1, 2006	44,450	\$ 27.75	
Restricted shares granted	295,337	26.02	
Restricted shares vested	(13,276)	27.09	
Restricted shares forfeited	(18,465)	26.07	
Nonvested restricted shares at June 30, 2007	308,046	\$ 26.65	

As of June 30, 2007, there were 6,268,751 shares of Class A common stock reserved for issuance under the 2002 Stock Incentive Plan.

**Pro Forma Disclosures**

Under the modified prospective method, results for the year ended June 30, 2005 were not restated to include stock option expense. The previously disclosed pro forma effects of recognizing the estimated fair value of stock-based employee compensation for the year ended June 30, 2005 (in thousands, except per share amounts) are presented below.

# Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

	2005
Net income, as reported	\$ 57,723
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	317
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(5,845)
Pro forma net income	\$ 52,195
Earnings per share:	
Basic as reported	\$ 1.09
Basic pro forma	\$ 0.99
Diluted as reported	\$ 1.02
Diluted pro forma	\$ 0.92

F-17

**Table of Contents****Employee Stock Purchase Plan**

The Company maintains the SRA International, Inc. 2004 Employee Stock Purchase Plan (ESPP) and has reserved 500,000 shares for issuance thereunder. The ESPP was available to all eligible employees beginning on January 1, 2005. The ESPP permits eligible employees to purchase class A common stock, through payroll deductions of up to 15% of the employee's compensation, at a price equal to 100% of the average of the high and low price of the common stock on the last day of each offering period. Employees purchased 47,347 and 36,179 shares for the years ended June 30, 2007 and 2006, respectively, under the ESPP.

**11. Income Taxes:**

The provision for federal and state income taxes for the years ended June 30, 2007, 2006, and 2005, included the following (in thousands):

	2007	2006	2005
Current provision:			
Federal	\$ 37,789	\$ 33,802	\$ 31,328
State	7,278	6,778	7,071
Deferred provision:			
Federal	(5,127)	(1,622)	(2,268)
State	(595)	(279)	(1,302)
Total income tax provision	\$ 39,345	\$ 38,679	\$ 34,829

The Company's effective income tax rate varied from the statutory federal income tax rate for the years ended June 30, 2007, 2006, and 2005 as follows:

	2007	2006	2005
Statutory federal income tax rate	35.0%	35.0%	35.0%
State income taxes, net of federal income tax benefit	4.2	4.2	4.2
Stock-based compensation	0.0	0.1	0.1
Municipal bond interest	(0.9)	(0.5)	(0.9)
Refunds and credits	(0.1)	(0.8)	(1.0)
Nondeductible expenses and other	0.1	0.2	0.2
Effective tax rate	38.3%	38.2%	37.6%

The components of the net deferred tax asset as of June 30, 2007 and 2006 were as follows (in thousands):

	2007	2006
Deferred tax assets:		
Compensated absences and other accruals not yet deductible for tax purposes	\$ 16,973	\$ 14,762
Financial statement depreciation in excess of tax depreciation	6,037	3,464
Deferred compensation	2,569	1,987
Nonqualified stock awards	9,061	4,927
State job creation credits	201	399
Total deferred tax assets	34,841	25,539
Deferred tax liabilities:		
Identified intangibles	(8,188)	(5,809)

Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

Prepaid expenses	(6,571)	(2,804)
Unbilled contract revenue	(4,579)	(7,228)
Capitalized software	(1,480)	(1,397)
Other		
Total deferred tax liabilities	(20,818)	(17,238)
Net deferred tax asset	\$ 14,023	\$ 8,301

F-18



**Table of Contents****12. Commitments and Contingencies:****Government Contracting**

Payments to the Company on cost-plus-fee contracts are provisional and are subject to adjustment upon audit by the Defense Contract Audit Agency. Audits through June 30, 2005 have been completed. In the opinion of management, audit adjustments that may result from audits for periods after June 30, 2005 are not expected to have a material effect on the Company's financial position, results of operations, or cash flows.

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

**Leases**

Net rent expense for the years ended June 30, 2007, 2006, and 2005 was as follows (in thousands):

	2007	2006	2005
Office space	\$ 30,637	\$ 27,649	\$ 23,726
Sublease income	(1,486)	(1,085)	(936)
Subtotal	29,151	26,564	22,790
Furniture and equipment	707	881	737
Total	\$ 29,858	\$ 27,445	\$ 23,527

The following table summarizes our future minimum rental commitments under noncancellable operating leases, primarily for office space, as of June 30, 2007 (in thousands).

	Rental Commitments	Sublease Income	Net Commitments
Years ending June 30,			
2008	\$ 28,971	\$ 631	\$ 28,340
2009	26,732	632	26,100
2010	23,102		23,102
2011	18,954		18,954
2012	16,790		16,790
Thereafter	56,622		56,622
Total minimum lease payments	\$ 171,171	\$ 1,263	\$ 169,908

The Company leases all of its office facilities. Leases for certain office space entitle the Company to incentives for tenant improvements, rent holidays, or rent escalation clauses pursuant to its lease agreements. The incentives for tenant improvements are recorded as liabilities and amortized as reductions in rent expense over the term of the respective leases. The Company recognizes rent expense, including escalated rent and rent holidays, on a straight-line basis over the term of the lease. Certain lease commitments are subject to adjustment based on changes in the Consumer Price Index.

Capitalized lease obligations included in accounts payable and accrued expenses were \$58,000 and \$146,000 as of June 30, 2007 and 2006 and represent the current portion of amounts due under leases for the use of computers and other equipment. The long-term portion of the capital

## Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

lease obligations was approximately \$350,000 and \$46,000 at June 30, 2007 and 2006, respectively and is included in other long-term liabilities. Included in property and equipment are related assets of \$1,018,879 and \$1,362,000 less accumulated amortization of \$522,000 and \$1,187,000 as of June 30, 2007 and 2006, respectively.

### **13. Litigation**

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

F-19

## **Table of Contents**

### **14. Related Party Transactions:**

In May 2001, Mantas, which was previously one of our service offerings, was contributed to a separate company, Mantas, Inc., which was formed with funding and other contributions received from unrelated third parties. Mantas, Inc. is a provider of services to the financial services industry to address anti-money laundering and other data mining issues.

In October 2006, i-flex solutions completed its acquisition of Mantas, Inc. The Company's portion of the net sale proceeds was approximately \$4.4 million, including a portion to be held in escrow. The Company recognized a total pre-tax gain of approximately \$3.7 million during fiscal 2007. The remaining amount held in escrow will be recognized as a gain upon the release of funds pursuant to the terms of the escrow agreement.

For the periods presented, Mantas, Inc. utilized certain services provided by the Company, for which Mantas, Inc. reimbursed the Company for such services. The Company allowed Mantas, Inc. to obtain certain travel and insurance-related services utilizing the Company's existing relationships with vendors. The total of such services received by Mantas, Inc. was approximately \$183,000 for the year ended June 30, 2005. Additionally, the Company provided labor services when requested by Mantas, Inc. to support its administrative and client support activities. Approximately \$304,000 of such labor services were provided for the year ended June 30, 2005.

### **15. Segment Reporting:**

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. Although the Company is organized by strategic business unit, the Company considers each of its government contracting units to have similar economic characteristics, provide similar types of services, and have a similar customer base. Accordingly, the Company reports one operating segment for financial reporting purposes, the Consulting & System Integration (C&SI) business, which aggregates all of its current operations.

The C&SI segment represents the Company's core business and includes high-end consulting services and information technology solutions primarily for federal government clients. Since October 2002, the C&SI segment has represented all of the Company's ongoing operations.

### **16. Acquisitions:**

#### **Touchstone Consulting Group, Inc.**

In April 2005, the Company completed its acquisition of Touchstone Consulting Group, Inc., or Touchstone, a privately-held management consultancy with an established track record of serving senior executives in the federal government. Touchstone provides strategic consulting services to its customers throughout the federal government, including the Department of Homeland Security, Department of Defense, intelligence agencies, and the Office of Management and Budget. The Company acquired Touchstone for approximately \$37.0 million net of acquisition costs, from cash on hand. Approximately \$6.5 million of the purchase price was allocated to identified intangibles and approximately \$26.5 million to goodwill. Pursuant to the requirements of SFAS No. 141 Business Combinations, the effect of the acquisition did not meet the criteria of a material and significant acquisition, and therefore, pro forma disclosures are not presented in these consolidated financial statements.

#### **Galaxy Scientific Corporation**

In July 2005, the Company completed its acquisition of Galaxy Scientific Corporation, or Galaxy, a privately-held provider of systems engineering, information technology, and tactical communication services and solutions to the federal government. Galaxy specializes in command and control, communications, computers and intelligence (C4I) tactical systems; information assurance; information technology; training systems; engineering support; and safety and security technologies. The Company acquired Galaxy for approximately \$98.7 million, net of acquisition costs, from cash on hand. Approximately \$12.0 million of the purchase price was allocated to identified intangibles and approximately \$73.4 million to goodwill. Pursuant to the requirements of SFAS No. 141, Business Combinations, the acquisition did not meet the criteria of a material and significant acquisition, and therefore, pro forma disclosures are not presented in these consolidated financial statements.

**Table of Contents****Spectrum Solutions Group, Inc.**

In November 2005, the Company acquired Spectrum Solutions Group, Inc., or Spectrum, a privately-held provider of enterprise solutions such as Oracle, SAP, PeopleSoft, and Seibel applications and technologies to the federal government. The Company acquired Spectrum for approximately \$9.7 million, net of acquisition costs, from cash on hand. Approximately \$0.9 million of the purchase price was allocated to identified intangibles and approximately \$6.7 million to goodwill. The Company agreed to make additional purchase price payments contingent upon the achievement of certain milestones by Spectrum. In January 2007, the Company paid former shareholders of Spectrum \$8.0 million in additional purchase price. This additional purchase price payment resulted in an \$8.0 million addition to goodwill. A final additional purchase price payment, if certain milestones are met, will be paid to the former shareholders of Spectrum in the quarter ending September 30, 2008. Pursuant to the requirements of SFAS No. 141, Business Combinations, the acquisition did not meet the criteria of a material and significant acquisition, and therefore, pro forma disclosures are not presented in these consolidated financial statements.

**Mercomms Unlimited, Inc.**

Effective April 10, 2006, SRA acquired Mercomms Unlimited, Inc., or Mercomms, which specializes in advanced maritime and defense communications technologies for the federal government. Mercomms was acquired for approximately \$637,000, substantially all of which was assigned to identified intangibles. Pursuant to the requirements of SFAS No. 141, Business Combinations, the acquisition did not meet the criteria of a material and significant acquisition, and therefore, pro forma disclosures are not presented in these consolidated financial statements.

**RABA Technologies, LLC**

In October 2006, the Company completed its acquisition of RABA Technologies, LLC or RABA, a provider of high-end technical services to the national security and intelligence communities. RABA's services include software development, systems integration and operational support. The Company acquired RABA for approximately \$95.0 million, net of acquisition costs, from cash on hand. Approximately \$11.4 million of the purchase price was allocated to identified intangible assets and approximately \$79.2 million to goodwill.

If certain milestones are met, an additional purchase price payment of up to \$5.0 million will be paid to the former stockholders of RABA. If paid, this contingent payment will result in additional goodwill in fiscal year 2009. Pursuant to the requirements of SFAS No. 141 Business Combinations, the acquisition did not meet the criteria of a material and significant acquisition, and therefore, pro forma disclosures are not presented in these consolidated financial statements.

**17. Quarterly Financial Data (Unaudited) (in thousands, except per share amounts):**

	Revenue	Operating Income	Income Before Taxes	Net Income	Earnings	
					Per Share (a)	
					Basic	Diluted
<b>Year Ended June 30, 2007</b>						
1 <sup>st</sup> Quarter	\$ 304,034	\$ 22,831	\$ 24,674	\$ 15,121	\$ 0.27	\$ 0.26
2 <sup>nd</sup> Quarter	321,045	22,064	27,209	16,683	0.30	0.29
3 <sup>rd</sup> Quarter	317,586	22,779	23,952	14,973	0.26	0.26
4 <sup>th</sup> Quarter	326,207	25,151	26,940	16,653	0.29	0.28
<b>Year Ended June 30, 2006</b>						
1 <sup>st</sup> Quarter	\$ 280,695	\$ 22,788	\$ 23,521	\$ 14,390	\$ 0.27	\$ 0.25
2 <sup>nd</sup> Quarter	305,313	24,220	25,257	15,903	0.29	0.28
3 <sup>rd</sup> Quarter	296,098	23,019	23,845	14,783	0.27	0.26
4 <sup>th</sup> Quarter	297,161	26,940	28,576	17,444	0.31	0.30

(a) The sum of earnings per share for the four quarters may differ from the annual earnings per share due to the required method of computing the weighted-average number of shares in the interim period.

**18. Subsequent Event:*****Acquisition of Constella Group, LLC***

## Edgar Filing: SRA INTERNATIONAL INC - Form 10-K

On August 9, 2007, the Company completed its acquisition of all of the outstanding stock of Constella Group LLC, or Constella, for approximately \$186.9 million in cash. Approximately \$51.6 million of the purchase price was used to repay all outstanding debt obligations of Constella on the closing date. Approximately \$16.0 million was placed into escrow as security for the payment, if any, of post-closing net asset adjustments and to secure indemnification obligations. The equity

F-21

## **Table of Contents**

purchase agreement has been filed as Exhibit 2.2 to this report. Constella is a privately-held provider of global health consulting services. Headquartered in Durham, NC, Constella employs more than 1,500 professionals organized by three interrelated service offerings: domestic health sciences, international health development and global drug development. Financing for the acquisition consisted of available cash and borrowings under a credit facility obtained prior to closing.

### ***Revolving Credit Facility***

On August 9, 2007, the Company entered into a \$100.0 million five-year unsecured revolving credit facility. The agreement has an accordion feature enabling the credit facility to be increased by an additional \$100.0 million, subject to specified conditions. Outstanding borrowings under the agreement bear interest at a LIBOR based interest rate (currently LIBOR plus 75 basis points). Interest is payable throughout the period a borrowing is outstanding. The Company borrowed \$100.0 million under this credit line to fund part of the acquisition of Constella.

F-22

**Table of Contents****SRA INTERNATIONAL, INC. AND SUBSIDIARIES****Years Ended June 30, 2007, 2006 and 2005****Schedule II Valuation and Qualifying Accounts**

Activity in the Company's allowance accounts for the years ended June 30, 2007, 2006, and 2005, was as follows (in thousands):

**Allowance for Doubtful Accounts**

<b>Period</b>	<b>Balance at Beginning of Period</b>	<b>Charged to Costs and Expenses</b>	<b>Deductions</b>	<b>Other</b>	<b>Balance at End of Period</b>
2007	\$1,614	\$1,510	\$567	\$ 132*	\$2,689
2006	1,159	75	49	429*	1,614
2005	1,425	74	380	40*	1,159

Allowance for Unbillable Amounts

<b>Period</b>	<b>Balance at Beginning of Period</b>	<b>Charged to Costs and Expenses</b>	<b>Deductions</b>	<b>Other</b>	<b>Balance at End of Period</b>
2007	\$1,735	\$	\$128	\$	\$1,607
2006	1,852	21	138		1,735
2005	1,861	51	60		1,852

\* Represents allowances assumed in connection with acquisitions.