ICF International, Inc.
Form 10-Q
November 03, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED SEPTEM SEPTEMBER 30, 2011 BER 30, 2011

OR

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

FOR THE TRANSITION PERIOD FROM TO

Commission File Number: 001-33045

ICF International, Inc.

(Exact name of Registrant as Specified in its Charter)

Delaware	22-3661438
(State or Other Jurisdiction of	**(I.R.S. Employer**
Incorporation or Organization)	**Identification No.)**

9300 Lee Highway, Fairfax, VA	22031
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant s telephone number, including area code: (703) 934-3000

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

As of October 31, 2011, there were 19,766,104 shares outstanding of the registrant s common stock.

ICF INTERNATIONAL, INC.

QUARTERLY REPORT ON FORM 10-Q FOR THE

PERIOD ENDED SEPTEMBER 30, 2011

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

ICF International, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS

(in thousands, except share amounts)

	September 30, 2011 *(Unaudited)*	December 31, 2010
Current Assets:		
Cash	$ 2,010	$ 3,301
Contract receivables, net	187,168	176,963
Prepaid expenses and other	8,673	6,995
Income tax receivable	1,503	1,628
Deferred income taxes	5,752	4,973
Total current assets	205,106	193,860
Total property and equipment, net	16,843	18,887
Other assets:		
Goodwill	327,032	323,467
Other intangible assets, net	20,817	26,148
Restricted cash	1,551	3,179
Other assets	6,846	7,278
Total Assets	$ 578,195	$ 572,819
Current Liabilities:		
Accounts payable	$ 32,490	$ 29,866
Accrued salaries and benefits	44,235	40,750
Accrued expenses	26,695	25,522
Deferred revenue	20,887	20,034
Total current liabilities	124,307	116,172
Long-term Liabilities:		
Long-term debt	50,000	85,000
Deferred rent	6,828	5,142
Deferred income taxes	8,379	10,068
Other	5,100	3,704
Total Liabilities	194,614	220,086
Commitments and Contingencies		
Stockholders Equity:		
Preferred stock, par value $.001 per share; 5,000,000 shares authorized; none issued		
Common stock, $.001 par value; 70,000,000 shares authorized; 19,871,832 and 19,618,659 issued; and 19,764,630 and 19,567,571 outstanding as of September 30, 2011, and December 31, 2010, respectively	20	20
Additional paid-in capital	227,031	220,891

Retained earnings		159,660		133,637
Treasury stock		(2,595)		(1,291)
Accumulated other comprehensive loss		(535)		(524)
Total Stockholders Equity		383,581		352,733
Total Liabilities and Stockholders Equity	$	578,195	$	572,819

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

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ICF International, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF EARNINGS (UNAUDITED)

(in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Gross Revenue	$ 218,691	$ 197,711	$ 626,828	$ 571,796
Direct Costs	137,343	124,060	389,086	356,750
Operating costs and expenses:				
Indirect and selling expenses	60,341	55,348	177,537	162,508
Depreciation and amortization	2,544	2,716	8,083	8,027
Amortization of intangible assets	2,369	3,082	7,105	9,245
Total operating costs and expenses	65,254	61,146	192,725	179,780
Operating income	16,094	12,505	45,017	35,266
Interest expense	(539)	(776)	(1,732)	(2,656)
Other income		99	89	197
Income before income taxes	15,555	11,828	43,374	32,807
Provision for income taxes	6,221	4,435	17,351	12,793
Net income	$ 9,334	$ 7,393	$ 26,023	$ 20,014
Earnings per Share:				
Basic	$ 0.47	$ 0.38	$ 1.32	$ 1.03
Diluted	$ 0.47	$ 0.38	$ 1.31	$ 1.02
Weighted-average Shares:				
Basic	19,728	19,413	19,666	19,349
Diluted	19,860	19,630	19,888	19,579

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

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ICF International, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(in thousands)

	Nine Months Ended September 30,	
	2011	**2010**
Cash flows from operating activities		
Net income	$ 26,023	$ 20,014
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred income taxes	(2,525)	(3,690)
(Gain) loss on disposal of fixed assets	(13)	36
Non-cash equity compensation	4,786	6,242
Depreciation and amortization	15,188	17,272
Deferred rent	1,809	753
Changes in operating assets and liabilities, net of the effect of acquisitions:		
Contract receivables, net	(8,537)	4,715
Prepaid expenses and other assets	(1,745)	(2,070)
Accounts payable	2,718	(5,301)
Accrued salaries and benefits	3,086	12,609
Accrued expenses	2,023	2,702
Deferred revenue	852	(2,874)
Income tax receivable and payable	118	5,278
Restricted cash	1,628	(1,041)
Other liabilities	1,395	(1,039)
Net cash provided by operating activities	46,806	53,606
Cash flows from investing activities		
Capital expenditures	(6,889)	(4,706)
Capitalized software development costs	(28)	(306)
Payments for business acquisitions, net of cash received	(6,220)	
Net cash used in investing activities	(13,137)	(5,012)
Cash flows from financing activities		
Advances from working capital facilities	104,469	22,094
Payments on working capital facilities	(139,469)	(67,094)
Debt issue costs		(21)
Proceeds from exercise of options	447	616
Tax benefits of stock option exercises and award vesting	815	784
Net payments for stockholder issuances and buybacks	(1,211)	(595)
Net cash used in financing activities	(34,949)	(44,216)
Effect of exchange rate on cash	(11)	(233)
Increase (decrease) in cash	(1,291)	4,145
Cash, beginning of period	3,301	2,353
Cash, end of period	$ 2,010	$ 6,498

Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Interest	$ 1,694	$ 3,141
Income taxes	$ 19,174	$ 10,882

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

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Notes to Consolidated Financial Statements

(Dollar amounts in tables in thousands, except per share amounts)

Note 1. Basis of Presentation and Nature of Operations

Interim Results

The unaudited consolidated financial statements included in this Quarterly Report on Form 10-Q have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). These rules and regulations permit some of the information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) to be condensed or omitted. In management s opinion, the unaudited consolidated financial statements contain all adjustments, that are of a normal recurring nature, necessary for a fair presentation of the results of ICF International, Inc. and its subsidiaries (collectively, the Company) for the three-month and nine-month periods ended September 30, 2011, and September 30, 2010. Operating results for the three-month and nine-month periods ended September 30, 2011, are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. The Company believes the carrying values of cash and cash equivalents, accounts receivable, accounts payable, accrued expenses, and other current liabilities approximate their estimated fair values at September 30, 2011, due to their short maturities. The Company believes the carrying value of the lines of credit payable approximate the estimated fair value for debt with similar terms, interest rates, and remaining maturities currently available to companies with similar credit ratings at September 30, 2011. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2010, and the notes thereto included in the Company s Annual Report on Form 10-K, filed with the SEC on March 4, 2011.

Nature of Operations

The Company provides management, technology, and policy professional services in the areas of energy, environment, and transportation; health, education, and social programs; and homeland security and defense. The Company s major clients are United States (U.S.) government departments and agencies, especially the Department of Health and Human Services (HHS), Department of Defense (DoD), Department of State (DOS), Environmental Protection Agency (EPA), Department of Homeland Security (DHS), Department of Agriculture (USDA), Department o Housing and Urban Development (HUD), Department of Transportation (DOT), Department of Interior (DOI), Department of Justice (DOJ), Department of Energy (DOE), and Department of Education (ED); state and local government departments and agencies; commercial and international clients, primarily in the air transportation and energy sectors, including airlines, airports, electric and gas utilities, oil companies, and law firms; and other governmental organizations throughout the U.S. and the world. The Company offers a full range of services to these clients, including strategy, analysis, program management, and information technology solutions that combine experienced professional staff, industry and institutional knowledge, and analytical methods.

The Company, incorporated in Delaware, is headquartered in Fairfax, Virginia, with over 50 domestic regional offices and international offices in Beijing, New Delhi, Ottawa, Toronto, Brussels, London, Moscow, and Rio de Janeiro.

Note 2. Business Combinations

In September 2011, the Company hired the staff and purchased select assets and liabilities of AeroStrategy L.L.C., a Michigan limited liability company, and AeroStrategy Limited, a limited company organized under the laws of England (collectively, AeroStrategy), an international aviation and aerospace management consulting firm. The purchase was immaterial to the financial statements taken as a whole. The purchase strengthened ICF s aviation consulting business with additional services and an expanded client base.

In January 2011, the Company completed the acquisition of Marbek Resource Consultants Ltd. (Marbek), a Canadian energy and environmental consulting firm. The acquisition was immaterial to the financial statements taken as a whole. The acquisition created an integrated energy, climate, and environmental consultancy with a strong presence in Canada.

Note 3. Contract Receivables

Contract receivables consisted of the following:

	September 30, 2011	December 31, 2010
Billed	$ 121,987	$ 127,452
Unbilled	66,175	51,433
Allowance for doubtful accounts	(994)	(1,922)
Contract receivables, net	$ 187,168	$ 176,963

Contract receivables, net of the established allowance, are amounts expected to be received in future periods. Unbilled receivables result from revenue that has been earned in advance of billing. The unbilled receivables can be invoiced at contractually defined

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intervals or milestones, or upon completion of the contract or U.S. federal government incurred-cost audits. The Company anticipates that the majority of unbilled receivables will be substantially billed and collected within one year. Contract receivables are classified as current assets in accordance with industry practice.

The allowance for doubtful accounts is determined based upon management s best estimate of potentially uncollectible contract receivables. The factors that influence management s estimate include historical experience and management s expectations of future losses on a contract-by-contract basis. The Company writes off contract receivables when such amounts are determined to be uncollectible. Losses have historically been within management s expectations.

Note 4. Commitments and Contingencies

Litigation and Claims

The Company is involved in various legal matters and proceedings arising in the ordinary course of business. While these matters and proceedings cause the Company to incur costs, including, but not limited to, attorneys fees, the Company currently believes that any ultimate liability arising out of these matters and proceedings will not have a material adverse effect on the Company s financial position, results of operations, or cash flows.

Commitments

In April 2011, the Company entered into a new lease for operating space in Gaithersburg, Maryland, which will consolidate certain operations into a single location. Rent expense will be recognized on a straight line basis over the term of the lease beginning in the second quarter of 2012. Aggregate rent expense over the 12-year, 8-month period will be approximately $43.8 million.

Note 5. Debt

The Company entered into its Second Amended and Restated Business Loan and Security Agreement (Credit Facility) on February 20, 2008, with a syndication of nine commercial banks to allow for borrowings of up to $350.0 million for a period of five years (maturing February 20, 2013) under a revolving line of credit. The Credit Facility provides for borrowings of up to $275.0 million without a borrowing base requirement and also provides for an accordion feature, which permits additional revolving credit commitments of up to $75.0 million, subject to lenders approval. The Credit Facility provides for pre-approval by the lenders for acquisitions with individual purchase prices of up to $75.0 million, if certain conditions are met. The Credit Facility is collateralized by substantially all of the assets of the Company, and requires that the Company remain in compliance with certain financial and non-financial covenants. The financial covenants, as defined by the Credit Facility, require that the Company maintain, on a consolidated basis for each quarter, a fixed charge coverage ratio of not less than 1.25 to 1.00 and a leverage ratio of not more than 3.50 to 1.00. As of September 30, 2011, the Company was in compliance with the covenants under the Credit Facility.

On March 31, 2009, the Credit Facility was amended to allow for the acquisition of Macro International Inc. (Macro), for permission to sell capital stock in one or more offerings (provided that the proceeds are used to pay down the Credit Facility), and to increase the interest rate margins the Company pays to borrow funds under the Credit Facility. On September 22, 2011, the Credit Facility was amended to allow for increased spending on annual capital expenditures from 1.5% to 2.0% of gross annual revenue. The Company has the ability to borrow funds under its Credit Facility at interest rates based on both LIBOR and prime rates, at its discretion, plus their applicable margins. Interest rates on debt outstanding ranged from 1.97% to 2.09% during the third quarter of 2011.

As of September 30, 2011, the Company had $50.0 million in long-term debt outstanding, $1.7 million in outstanding letters of credit, and unused borrowing capacity of $223.3 million under the Credit Facility. During the third quarter ended September 30, 2011, the Company decreased its long-term debt outstanding by $13.4 million.

Note 6. Accounting for Stock-Based Compensation

The Company recognized stock-based compensation expense of $1.8 million and $4.8 million for the three months and nine months ended September 30, 2011, respectively, and $2.4 million and $6.2 million for the three months and nine months ended September 30, 2010, respectively. Unrecognized compensation expense of $18.4 million as of September 30, 2011, related to unvested stock-based compensation agreements, will be recognized over the next three years. For the nine months ended September 30, 2011, the Company granted approximately 0.6 million shares in the form of equity compensation. As of September 30, 2011, the Company had 1.8 million shares available to grant under its equity compensation plan.

Note 7. Income Taxes

The Company s effective tax rate for both the three-month and nine-month periods ended September 30, 2011, was 40.0%. The gross unrecognized tax benefits were $1.1 million at September 30, 2011. The offsetting tax benefit at September 30, 2011, was $0.3 million. If recognized, $0.8 million of the net unrecognized tax benefits at September 30, 2011, would impact the effective tax rate.

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The Company files income tax returns with the U.S. federal government and various state and foreign jurisdictions. The 2008 through 2010 tax years remain subject to examination by the Internal Revenue Service, and the 2007 through 2010 tax years generally remain subject to examination by state authorities. The Company does not anticipate a significant increase or decrease in total unrecognized tax benefits during the next 12 months.

The Company reports penalties and interest related to unrecognized tax benefits in net income before tax. For the nine months ended September 30, 2011, the Company recognized less than $0.1 million of penalties and interest.

The Company has made no provision for deferred U.S. income taxes or additional foreign taxes on future unremitted earnings of its controlled foreign subsidiaries because the Company considers these earnings to be permanently invested.

Note 8. Earnings Per Share

Basic earnings per share (EPS) is computed by dividing reported net income by the weighted-average number of shares outstanding. Diluted EPS considers the potential dilution that could occur if common stock equivalents were exercised or converted into stock. The difference between the basic and diluted weighted-average equivalent shares with respect to the Company s EPS calculation is due entirely to the assumed exercise of stock options, the vesting of restricted stock, and the settlement of restricted stock units (RSUs). The dilutive effect of stock options, restricted stock and RSUs exclude shares that would be anti-dilutive to the calculation of EPS if included. For the three-month and nine-month periods ended September 30, 2011, approximately 0.3 million anti-dilutive weighted-average shares have been excluded, and for the three-month and nine-month periods ended September 30, 2010, approximately 0.2 million and 0.1 million anti-dilutive weighted-average shares have been excluded, respectively. The dilutive effect of stock option, restricted stock and RSU awards for each period reported is summarized below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net Income	$ 9,334	$ 7,393	$ 26,023	$ 20,014
Weighted-average number of basic shares outstanding during the period	19,728	19,413	19,666	19,349
Dilutive effect of stock options, restricted stock and RSUs	132	217	222	230
Weighted-average number of diluted shares outstanding during the period	19,860	19,630	19,888	19,579
Basic earnings per share	$ 0.47	$ 0.38	$ 1.32	$ 1.03
Diluted earnings per share	$ 0.47	$ 0.38	$ 1.31	$ 1.02

Note 9. Recent Pronouncements

ASU 2011-08, Intangibles Goodwill and Other (Topic 350): Testing Goodwill for Impairment. In September 2011, the Financial Accounting Standards Board (FASB) revised the guidance related to testing goodwill for impairment. The new guidance permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount, as a basis for determining whether it is necessary to perform the first step of the two-step goodwill impairment test required under existing guidance. The more likely than not threshold is defined as having a likelihood of more than 50 percent. If, upon assessing the qualitative factors in their totality, an entity determines that it is not more likely than not that the fair value of a reporting unit is less than its carrying value, then performing the two-step impairment test is unnecessary. However, if an entity determines that it is more likely than not, then it is required to perform the first step of the two-step impairment test. In addition, an entity is no longer permitted to carry forward its detailed calculation of a reporting unit s fair value from a prior year as previously permitted. Early adoption is permitted for annual and interim goodwill impairment tests and the Company has elected to do so. As a result of the adoption, the Company determined that it is not more likely than not that the fair value of its one reporting unit is less than its carrying value and therefore did not perform step one of the two-step impairment test.

ASU 2009-14, Software (Topic 985): Certain Revenue Arrangements That Include Software Elements. In October 2009, the FASB also revised the guidance related to software revenue and multiple-element arrangements with software components. The new guidance related to software revenue recognition excludes arrangements with tangible products containing software and non-software components that function together to

deliver a product s essential functionality. Prior to the new guidance, vendor-specific-objective-evidence (VSOE) of fair value was required for the undelivered elements in the arrangement in order for the Company to account for the elements separately. However, as a result of the new guidance noted below with respect to multiple-deliverable arrangements and the guidance related to software revenue recognition, VSOE may not be required if another topic of the accounting standards codification provides guidance on how to allocate the consideration for contract deliverables. Thus, if there are software and non-

software components within the same contract and the software components fall within the scope of the *Software Elements* topic of the code, but that topic addresses solely separation and not allocation, one can now refer back to the *Multiple Deliverables* topic of the codification for guidance on consideration allocation. The *Multiple Deliverables* guidance allows consideration to be allocated based upon a relative fair value basis using the entity s best estimate of fair value, which is no longer limited to VSOE or third-party evidence, but may entail management s best estimate of selling price. The guidance was effective for the Company beginning January 1, 2011. The new guidance did not have a material impact on the Company s financial condition or results of operations.

ASU 2009-13, Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements. In October 2009, the FASB revised the accounting guidance pertaining to revenue arrangements with multiple deliverables. Prior to this guidance, in order for deliverables within an arrangement to be separated, the items must have stand-alone value as defined by the statement and there must be objective and reliable evidence of fair value for all elements or at a minimum the undelivered elements within the arrangement. Objective and reliable evidence of fair value meant there was VSOE of fair value, which consisted of the price charged when the deliverable was sold separately or a price established by management with the authority to establish the price for the item before it was to be sold separately. If VSOE did not exist, third-party evidence was also acceptable. The new standard allows for the use of an estimated management selling price to determine the value of deliverables within an arrangement when VSOE or third-party evidence does not exist. The new guidance also eliminated the use of the residual method of allocation allowed in the previous guidance. The Company has multiple-deliverable arrangements. The guidance was effective for the Company beginning January 1, 2011. The new guidance did not have a material impact on the Company s financial condition or results of operations.

Note 10. Subsequent Events

ICF s Board of Directors has approved a share repurchase program, authorizing the Company to repurchase in the aggregate up to $35.0 million of its outstanding common stock. Purchases under this program may be made from time to time at prevailing market prices in open market purchases or in privately-negotiated transactions in accordance with applicable insider trading and other securities laws and regulations. The purchases will be funded from existing cash balances and/or borrowings, and the repurchased shares will be held in treasury and used for general corporate purposes. The timing and extent to which the Company repurchases its shares will depend upon market conditions and other corporate considerations as may be considered in the Company s sole discretion.

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

FORWARD-LOOKING STATEMENTS

Some of the statements in this Quarterly Report on Form 10-Q constitute forward-looking statements as defined in 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, would, or similar w statements that contain these words carefully. The risk factors described in our filings with the SEC, as well as any cautionary language in this Quarterly Report on Form 10-Q, provide examples of risks, uncertainties, and events that may cause our actual results to differ materially from the expectations we describe in our forward-looking statements, including, but not limited to:

- our dependence on contracts with federal, state, and local government agencies and departments for the majority of our revenue;
- changes in the economic and political climate that may affect spending patterns and priorities of our clients;
- failure by Congress or other governmental bodies to approve budgets or other legislation in a timely fashion;
- results of government audits and investigations;
- failure to receive the full amount of our backlog;
- loss of members of management;
- difficulties implementing our acquisition strategy;
- difficulties expanding our service offerings and client base; and
- liabilities arising from our major contract with the State of Louisiana, which was completed in 2009.

The forward-looking statements are based on the beliefs and assumptions of our management and the information available to our management at the time these disclosures were prepared. Although we believe the expectations reflected in these 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 Quarterly Report on Form 10-Q. We undertake no obligation to update these forward-looking statements, even if our situation changes in the future.

The terms we, our, us, and the Company, as used throughout this Quarterly Report on Form 10-Q refer to ICF International, Inc. and its consolidated subsidiaries, unless otherwise indicated. The term federal government refers to the U.S. government, unless otherwise indicated.

OVERVIEW

We provide management, technology, and policy consulting and implementation services to government, commercial, and international clients. We help our clients conceive, develop, implement, and improve solutions that address complex natural resource, social, and national security

issues. Our services primarily address three key markets:

- Energy, environment, and transportation;
- Health, education, and social programs; and
- Homeland security and defense.

We provide services across these three markets that deliver value throughout the entire life of a policy, program, project, or initiative, from concept analysis and design through implementation and improvement. Our primary services include:

- ***Advisory Services.*** We provide policy, regulatory, technology, and other advice to our clients to help them address and respond to the challenges they face. Our advisory services include needs and market assessments, policy analysis, strategy and concept development, organizational assessment and strategy, enterprise architecture, and program design.
- ***Implementation Services.*** We implement and manage technological, organizational, and management solutions for our clients, including information technology solutions, project and program management, project delivery, strategic communications, and training. These services often relate to the advisory services we provide.
- ***Evaluation and Improvement Services.*** We provide evaluation and improvement services that help our clients increase the effectiveness and transparency of their programs. Our evaluation and improvement services include program evaluations, continuous improvement initiatives, performance management, benchmarking, and return-on-investment analyses.

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We serve federal, state, local, and foreign government clients, as well as major domestic and international corporations and multilateral institutions. Our clients utilize our advisory services because we offer a combination of deep subject-matter expertise and institutional experience in our market areas. We believe that our domain expertise and the program knowledge developed from our advisory engagements further position us to provide implementation and evaluation services.

We have more than 4,000 employees, including many recognized as thought leaders in their respective fields. The Company, incorporated in Delaware, is headquartered in Fairfax, Virginia, with over 50 domestic regional offices and international offices in Beijing, New Delhi, Ottawa, Toronto, Brussels, London, Moscow, and Rio de Janeiro.

OUTLOOK

Our future results will depend on the success of our strategy to enhance our client relationships and seek larger engagements across the program life cycle in our three key markets, and to complete additional acquisitions and to integrate them successfully. In our three markets, we will continue to focus on building scale in domain and horizontal expertise, developing our commercial, as well as our government, business and replicating our business model geographically throughout the United States and globally.

CRITICAL ACCOUNTING ESTIMATES

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 amount of assets, liabilities, revenue, and expenses, as well as the disclosure of contingent assets and liabilities. If any of these estimates or judgments proves to be incorrect, our reported results could be materially affected. Actual results may differ significantly from our estimates under different assumptions or conditions. We believe that the estimates, assumptions, and judgments involved in the accounting practices described below have the greatest potential impact on our financial statements and we therefore consider them to be critical accounting policies.

Revenue Recognition

We recognize revenue when persuasive evidence of an arrangement exists, services have been rendered, the contract price is fixed or determinable, and collectability is reasonably assured. We enter into contracts that are time-and-materials, cost-based, fixed-price, or a combination of these.

Time-and-Materials Contracts. Revenue for time-and-materials contracts is recorded on the basis of allowable labor hours worked multiplied by the contract-defined billing rates, plus the costs of other items used in the performance of the contract. Profits and losses on time-and-materials contracts result from the difference between the cost of services performed and the contract-defined billing rates for these services.

Cost-Based Contracts. Revenue under cost-based contracts is recognized as costs are incurred. Applicable estimated profit, if any, is included in earnings in the proportion that incurred costs bear to total estimated costs. Incentives, award fees, or penalties related to performance are also considered in estimating revenue and profit rates based on actual and anticipated awards.

Fixed-Price Contracts. Revenue for fixed-price contracts is recognized when earned, generally as work is performed. Services performed vary from contract to contract and are not always uniformly performed over the term of the arrangement. We recognize revenue in a number of different ways on fixed-price contracts, including:

Proportional Performance: Revenue on certain fixed-price contracts is recorded each period based upon certain contract performance measures (labor hours, labor costs, or total costs) incurred expressed as a proportion of a total project estimate. Thus, labor hours, labor costs, or total contract costs incurred to date are compared with the total estimate for these items at completion. Performance is based on the ratio of the incurred hours or costs to the total estimate. Progress on a contract is monitored regularly to ensure that revenue recognized reflects project status. When hours or costs incurred are used as the basis for revenue recognition, the hours or costs incurred represent a reasonable surrogate for output measures of contract

performance, including the presentation of deliverables to the client. Clients are obligated to pay as services are performed, and in the event that a client cancels the contract, payment for services performed through the date of cancellation is negotiated with the client.

Contractual Outputs: Revenue on certain fixed-price contracts is recognized based upon outputs completed to date expressed as a percentage of total outputs required in the contract or based upon units delivered to the customer multiplied by the contract-defined unit price.

Straight-Line: When services are performed or are expected to be performed consistently throughout an arrangement, revenue on those fixed-price contracts is recognized ratably over the period benefited.

Completed Contract: Revenue on certain fixed-price contracts is recognized at completion if the final act is so significant to the arrangement that value is deemed to be transferred only at completion.

Revenue recognition requires us to use judgment relative to assessing risks, estimating contract revenue and costs or other variables, and making assumptions for schedule and technical issues. Due to the size and nature of many of our contracts, the estimation of revenue and estimates at completion can be complicated and are subject to many variables. Contract costs include labor, subcontracting costs, and other direct costs, as well as an allocation of allowable indirect costs. We must also make assumptions regarding the length of time to complete the contract because costs include expected increases in wages, prices for subcontractors, and other direct costs. From time to time, facts develop that require us to revise our estimated total costs or hours and thus the associated revenue on a contract. 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. Provision for 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. As a result, operating results could be affected by revisions to prior accounting estimates.

We generate invoices to clients in accordance with the terms of the applicable contract, which may not be directly related to the performance of services. Unbilled receivables are invoiced based upon the achievement of specific events as defined by each contract, including deliverables, timetables, and incurrence of certain costs. Unbilled receivables are classified as a current asset. Advanced billings to clients in excess of revenue earned are recorded as deferred revenue until the revenue recognition criteria are met. Reimbursements of out-of-pocket expenses are included in revenue with corresponding costs incurred by us included in cost of revenue.

We may proceed with work based upon written 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 reliably be estimated and realization is probable. We base our estimates on a variety of factors, including previous experiences with the client, communications with the client regarding funding status, and our knowledge of available funding for the contract.

DIRECT COSTS

Direct costs consist primarily of costs incurred to provide services to clients, the most significant of which are subcontractors and employee salaries and wages, plus associated fringe benefits, relating to specific client engagements. Direct costs also include the costs of third-party materials and any other related direct costs, such as travel expenses.

We generally expect the ratio of direct costs as a percentage of revenue to decline when our own labor increases relative to subcontracted labor or outside consultants. Conversely, as our labor decreases relative to subcontracted labor or outside consultants, we expect the ratio to increase.

Changes in the mix of services and other direct costs provided under our contracts can result in variability in our direct costs as a percentage of revenue. For example, when we perform work in the area of implementation, we expect that more of our services will be performed in client-provided facilities and/or with dedicated staff. Such work generally has a higher proportion of direct costs than much of our current advisory work, and we anticipate that higher utilization of such staff will decrease indirect expenses. In addition, to the extent we are successful in winning larger contracts, our own labor services component could decrease because larger contracts typically are broader in scope and require more diverse capabilities, potentially resulting in more subcontracted labor, more other direct costs, and lower margins. Although these factors could lead to a higher ratio of direct costs as a percentage of 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.

OPERATING EXPENSES

Our operating costs and expenses consist of indirect and selling expenses, including non-cash compensation, and depreciation and amortization.

Indirect and selling expenses

Indirect and selling expenses include our management, facilities, and infrastructure costs for all employees, as well as salaries and wages, plus associated fringe benefits, not directly related to client engagements. Among the functions covered by these expenses are marketing, business and corporate development, bids and proposals, facilities, information technology and systems, contracts administration, accounting, treasury, human resources, legal, corporate governance, and executive and senior management. We include all of our cash incentive compensation in this item, as well as all our non-cash compensation, such as stock-based compensation provided to employees, whose compensation and other benefit costs are included in both direct costs and indirect and selling expenses.

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Equity compensation

Incentive stock awards are measured at fair value. We have elected to use the Black-Scholes-Merton option pricing model to value any options granted and to amortize compensation expense relating to share-based payments on a straight-line basis over the requisite service period. The Company will reconsider its 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 prevent their value from being reasonably estimated using this model.

Property and equipment

Property and equipment are carried at cost and are depreciated using the straight-line method over their estimated useful lives, which range from two to seven years. Leasehold improvements are amortized on a straight-line basis over the shorter of the economic life of the improvement or the related lease term. Assets acquired in acquisitions are recorded at fair value.

Goodwill and other intangible assets

Goodwill represents the excess of costs over fair value of assets of businesses acquired. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead reviewed annually (or more frequently if impairment indicators arise) for impairment. Intangible assets with estimable useful lives must be amortized over such lives and reviewed for impairment.

We have elected to perform our annual goodwill impairment review as of September 30 of each year. For the purposes of performing this review, we have concluded that the Company is one reporting unit. We have adopted the amended guidance under ASU 2011-08 issued in September 2011. We evaluated, on the basis of the weight of evidence, the significance of all identified events and circumstances in the context of determining whether it is more likely than not that the fair value of our one reporting unit is less than its carrying amount. This evaluation included macroeconomic and industry and market specific considerations, financial performance indicators and measurements, and other factors. We have determined that it is not more likely than not that the fair value of our one reporting unit is less than its carrying amount and that the two-step impairment test is not required to be performed for 2011. Therefore, based upon management s review, no goodwill impairment charge was required as of September 30, 2011.

We are required to review long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset might not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value. Assets to be disposed of are reported at the lower of the carrying amount or fair value, less cost to sell.

Recent pronouncements

New accounting standards are discussed in Note 9 Recent Pronouncements of our Notes to Consolidated Financial Statements appearing in this Quarterly Report on Form 10-Q.

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RESULTS OF OPERATIONS

Three Months ended September 30, 2011, compared to Three Months ended September 30, 2010

The following table sets forth certain items from our unaudited consolidated statements of earnings and the period-over-period rate of change in each of them and expresses these items as a percentage of revenue for the periods indicated.

	Three Months Ended September 30,				Year-to-Year Change Three Months Ended September 30, 2010 to 2011	
	2011	2010	2011	2010		
	Dollars (In Thousands)		Percentages		Dollars (In Thousands)	Percent
Gross Revenue	$ 218,691	$ 197,711	100.0%	100.0%	$ 20,980	10.6%
Direct Costs	137,343	124,060	62.8%	62.7%	13,283	10.7%
Operating Costs and Expenses						
Indirect and selling expenses	60,341	55,348	27.6%	28.0%	4,993	9.0%
Depreciation and amortization	2,544	2,716	1.1%	1.4%	(172)	(6.3)%
Amortization of intangible assets	2,369	3,082	1.1%	1.6%	(713)	(23.1)%
Total Operating Costs and Expenses	65,254	61,146	29.8%	31.0%	4,108	6.7%
Operating Income	16,094	12,505	7.4%	6.3%	3,589	28.7%
Other (Expense) Income						
Interest expense	(539)	(776)	(0.3)%	(0.4)%	237	(30.5)%
Other income		99			(99)	(100.0)%
Income before Income Taxes	15,555	11,828	7.1%	5.9%	3,727	31.5%
Provision for Income Taxes	6,221	4,435	2.8%	2.2%	1,786	40.3%
Net Income	$					