

MANTECH INTERNATIONAL CORP  
Form 10-Q  
November 06, 2006  
Table of Contents

---

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

WASHINGTON, D.C. 20549

---

**FORM 10-Q**

---

(Mark One)

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

For the quarterly period ended September 30, 2006

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 No. 000-49604

---

**ManTech International Corporation**

(Exact name of registrant as specified in its charter)

---

Delaware  
(State or other jurisdiction of  
incorporation or organization)

22-1852179  
(I.R.S. Employer  
Identification No.)

12015 Lee Jackson Highway, Fairfax, VA

22033

Edgar Filing: MANTECH INTERNATIONAL CORP - Form 10-Q

(Address of principal executive offices)

(703) 218-6000

(Zip Code)

(Registrant's telephone number, including area code)

---

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

As of November 1, 2006, there were issued and outstanding 18,656,257 shares of our Class A Common Stock and 15,063,043 shares of our Class B Common Stock.

---

**Table of Contents**

**MANTECH INTERNATIONAL CORPORATION**

**FORM 10-Q**

**FOR THE QUARTER ENDED September 30, 2006**

**INDEX**

|  | <b>Page No.</b> |
|--|-----------------|
| <b><u>PART I FINANCIAL INFORMATION</u></b>   | <b>3</b>        |
| Item 1. <u>Financial Statements</u>  | 3               |
| <u>Condensed Consolidated Balance Sheets at September 30, 2006 and December 31, 2005</u>   | 3               |
| <u>Condensed Consolidated Statements of Income for the Three and Nine Months Ended September 30, 2006 and 2005</u>               | 4               |
| <u>Condensed Consolidated Statements of Comprehensive Income for the Three and Nine Months Ended September 30, 2006 and 2005</u> | 5               |
| <u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2006 and 2005</u>                     | 6               |
| <u>Notes to Condensed Consolidated Financial Statements</u>  | 7               |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                             | 17              |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>  | 25              |
| Item 4. <u>Controls and Procedures</u>   | 25              |
| <b><u>PART II OTHER INFORMATION</u></b>  | <b>26</b>       |
| Item 1. <u>Legal Proceedings</u>   | 26              |
| Item 1A <u>Risk Factors</u>  | 26              |
| Item 6. <u>Exhibits</u>  | 27              |

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements**

**MANTECH INTERNATIONAL CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

(Dollars in Thousands)

|   | (unaudited)           |                      |
|---|-----------------------|----------------------|
|   | September 30,<br>2006 | December 31,<br>2005 |
| <b>ASSETS</b>   |                       |                      |
| <b>CURRENT ASSETS:</b>  |                       |                      |
| Cash and cash equivalents   | \$ 47,337             | \$ 5,662             |
| Receivables net   | 205,737               | 239,676              |
| Prepaid expenses and other  | 13,799                | 7,393                |
| Assets of operations held for sale  | 6,171                 | 4,831                |
| <b>Total current assets</b>   | <b>273,044</b>        | <b>257,562</b>       |
| Property and equipment net  | 12,746                | 11,713               |
| Goodwill  | 227,747               | 227,747              |
| Other intangibles net   | 34,434                | 35,602               |
| Employee supplemental savings plan assets   | 13,761                | 11,902               |
| Other assets  | 10,030                | 11,459               |
| <b>TOTAL ASSETS</b>   | <b>\$ 571,762</b>     | <b>\$ 555,985</b>    |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                       |                      |
| <b>CURRENT LIABILITIES:</b>   |                       |                      |
| Current portion of debt   | \$ 42                 | \$ 42,502            |
| Accounts payable and accrued expenses   | 61,233                | 57,933               |
| Accrued salaries and related expenses   | 42,059                | 41,428               |
| Deferred income taxes current   |                       | 663                  |
| Billings in excess of revenue earned  | 5,036                 | 6,611                |
| Liabilities of operations held for sale   | 3,833                 | 4,978                |
| <b>Total current liabilities</b>  | <b>112,203</b>        | <b>154,115</b>       |
| Debt net of current portion   |                       | 21                   |
| Accrued retirement  | 15,397                | 13,054               |
| Other long-term liabilities   | 3,295                 | 3,282                |
| Deferred income taxes non-current   | 8,232                 | 6,920                |
| <b>TOTAL LIABILITIES</b>  | <b>139,127</b>        | <b>177,392</b>       |
| <b>COMMITMENTS AND CONTINGENCIES</b>  |                       |                      |
| <b>STOCKHOLDERS EQUITY:</b>   |                       |                      |
| Common stock, Class A \$0.01 par value; 150,000,000 shares authorized; 18,619,453 and 18,016,328 shares issued and outstanding at September 30, 2006 and December 31, 2005, respectively. | 186                   | 180                  |
| Common stock, Class B \$0.01 par value; 50,000,000 shares authorized; 15,063,593 and 15,065,293 shares issued and outstanding at September 30, 2006 and December 31, 2005, respectively.  | 151                   | 151                  |
| Additional paid in capital  | 252,612               | 233,360              |

Edgar Filing: MANTECH INTERNATIONAL CORP - Form 10-Q

|  |                   |                   |
|--|-------------------|-------------------|
| Retained earnings                                | 181,685           | 144,903           |
| Unearned ESOP shares                             | (2,033)           |                   |
| Accumulated other comprehensive income (loss)    | 34                | (1)               |
| Deferred compensation                            | 640               | 640               |
| Shares held in grantor trust                     | (640)             | (640)             |
| <b>TOTAL STOCKHOLDERS EQUITY</b>                 | <b>432,635</b>    | <b>378,593</b>    |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b> | <b>\$ 571,762</b> | <b>\$ 555,985</b> |

See notes to condensed consolidated financial statements.

**Table of Contents****MANTECH INTERNATIONAL CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

(Dollars in Thousands Except Per Share Amounts)

|   | (unaudited)<br>Three months ended September 30, |            | (unaudited)<br>Nine months ended September 30, |            |
|---|---|------------|--|------------|
|   | 2006  | 2005       | 2006   | 2005       |
| <b>REVENUES</b>   | \$ 283,695                                      | \$ 262,431 | \$ 846,466                                     | \$ 719,300 |
| <b>COST OF SERVICES</b>   | 235,539   | 216,260    | 702,225  | 592,130    |
| <b>GROSS PROFIT</b>   | 48,156  | 46,171     | 144,241  | 127,170    |
| <b>COSTS AND EXPENSES:</b>  |   |            |  |            |
| General and administrative  | 22,951  | 22,327     | 69,731   | 62,510     |
| Depreciation and amortization   | 2,191   | 2,008      | 6,327  | 5,147      |
| <b>Total costs and expenses</b>   | 25,142  | 24,335     | 76,058   | 67,657     |
| <b>INCOME FROM CONTINUING OPERATIONS</b>                                  | 23,014  | 21,836     | 68,183   | 59,513     |
| Interest (expense), net   | (291)   | (1,120)    | (1,684)  | (1,956)    |
| Equity in earnings of affiliates  |   | 157        |  | 435        |
| Gain on disposal of an operation  |   |            |  | 3,698      |
| Other income (expense), net   | 21  | (52)       | 8  | (228)      |
| <b>INCOME BEFORE PROVISION FOR INCOME TAXES AND<br/>MINORITY INTEREST</b> | 22,744  | 20,821     | 66,507   | 61,462     |
| Provision for income taxes  | (8,962)   | (7,833)    | (26,204)                                       | (24,085)   |
| Minority interest   |   | (3)        |  | (9)        |
| <b>INCOME FROM CONTINUING OPERATIONS net of taxes</b>                     | 13,782  | 12,985     | 40,303   | 37,368     |
| (Loss) from discontinued operations net of taxes                          | (1,092)   | (1,298)    | (3,521)  | (3,612)    |
| <b>NET INCOME</b>   | \$ 12,690                                       | \$ 11,687  | \$ 36,782                                      | \$ 33,756  |
| <b>BASIC EARNINGS (LOSS) PER SHARE:</b>                                   |   |            |  |            |
| Income from continuing operations net of taxes                            | \$ 0.41   | \$ 0.39    | \$ 1.21  | \$ 1.14    |
| (Loss) from discontinued operations net of taxes                          | (0.03)  | (0.04)     | (0.11)   | (0.11)     |
| <b>Basic earnings per share</b>   | \$ 0.38   | \$ 0.35    | \$ 1.10  | \$ 1.03    |
| Weighted average common shares outstanding                                | 33,598,476                                      | 32,955,258 | 33,389,961                                     | 32,753,215 |
| <b>DILUTED EARNINGS (LOSS) PER SHARE:</b>                                 |   |            |  |            |
| Income from continuing operations net of taxes                            | \$ 0.41   | \$ 0.39    | \$ 1.19  | \$ 1.12    |
| (Loss) from discontinued operations net of taxes                          | (0.04)  | (0.04)     | (0.10)   | (0.10)     |
| <b>Diluted earnings per share</b>   | \$ 0.37   | \$ 0.35    | \$ 1.09  | \$ 1.02    |
| Weighted average common shares outstanding                                | 33,969,810                                      | 33,477,813 | 33,808,125                                     | 33,221,562 |

See notes to condensed consolidated financial statements.



**Table of Contents**

**MANTECH INTERNATIONAL CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(Dollars in Thousands)

|   | (unaudited)                      |           | (unaudited)                     |           |
|---|----------------------------------|-----------|---------------------------------|-----------|
|   | Three months ended September 30, |           | Nine months ended September 30, |           |
|   | 2006                             | 2005      | 2006                            | 2005      |
| <b>NET INCOME</b>                         | \$ 12,690                        | \$ 11,687 | \$ 36,782                       | \$ 33,756 |
| <b>OTHER COMPREHENSIVE INCOME (LOSS):</b> |                                  |           |                                 |           |
| Cash flow hedge                           |                                  | 134       |                                 | 470       |
| Translation adjustments                   | 13                               | (8)       | 35                              | (294)     |
| <b>Total other comprehensive income</b>   | 13                               | 126       | 35                              | 176       |
| <b>COMPREHENSIVE INCOME</b>               | \$ 12,703                        | \$ 11,813 | \$ 36,817                       | \$ 33,932 |

See notes to condensed consolidated financial statements.



**Table of Contents****MANTECH INTERNATIONAL CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Dollars in Thousands)

|  | (unaudited)                     |                  |
|--|---------------------------------|------------------|
|  | Nine months ended September 30, |                  |
|  | 2006                            | 2005             |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |                                 |                  |
| Net income   | \$ 36,782                       | \$ 33,756        |
| Adjustments to reconcile net income to net cash used in operating activities:                          |                                 |                  |
| Equity in earnings of affiliates   |                                 | (435)            |
| Decrease in deferred income taxes  | (2,278)                         | (2,210)          |
| Stock-based compensation   | 4,095                           | 18               |
| Tax benefit from the exercise of stock options for 2005  |                                 | 1,872            |
| Depreciation and amortization  | 7,259                           | 6,357            |
| Gain on disposal of an operation   |                                 | (3,698)          |
| Loss from discontinued operations  | 3,521                           | 3,612            |
| Changes in assets and liabilities-net of effects from acquired, disposed, and discontinued businesses: |                                 |                  |
| Receivables net  | 33,939                          | (23,587)         |
| Prepaid expenses and other   | (3,478)                         | 277              |
| Accounts payable and accrued expenses  | 3,300                           | 2,940            |
| Accrued salaries and related expenses  | 631                             | 1,220            |
| Billings in excess of revenue earned   | (1,575)                         | 3,385            |
| Accrued retirement   | 2,343                           | (1,100)          |
| Dividends from Vosper-Mantech Limited  |                                 | 357              |
| Other  | (1,513)                         | 1,108            |
| <b>Net cash flows from continuing operations</b>   | <b>83,026</b>                   | <b>23,872</b>    |
| <b>Net cash flows from discontinued operations</b>   | <b>(5,881)</b>                  | <b>14,137</b>    |
| <b>Net cash flows from operating activities</b>  | <b>77,145</b>                   | <b>38,009</b>    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>   |                                 |                  |
| Purchase of property and equipment   | (3,582)                         | (5,198)          |
| Investment in capitalized software for internal use  | (2,126)                         | (1,617)          |
| Acquisition of businesses, net of cash acquired  |                                 | (106,638)        |
| Proceeds from disposal of an operation   |                                 | 7,000            |
| <b>Net investing cash flows from continuing operations</b>   | <b>(5,708)</b>                  | <b>(106,453)</b> |
| <b>Net investing cash flows from discontinued operations</b>   | <b>(125)</b>                    | <b>(355)</b>     |
| <b>Net cash flows from investing activities</b>  | <b>(5,833)</b>                  | <b>(106,808)</b> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>   |                                 |                  |
| Proceeds from exercise of stock options  | 10,255                          | 9,201            |
| Tax benefit from the exercise of stock options for 2006  | 2,589                           |                  |
| Repayment of debt  | (79)                            | (60)             |
| Net (decrease) increase in borrowings under line of credit   | (42,402)                        | 50,000           |
| <b>Net cash flows from financing activities</b>  | <b>(29,637)</b>                 | <b>59,141</b>    |
| <b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>  | <b>41,675</b>                   | <b>(9,658)</b>   |

Edgar Filing: MANTECH INTERNATIONAL CORP - Form 10-Q

|   |           |           |
|---|-----------|-----------|
| <b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b> | 5,662     | 22,946    |
| <b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>       | \$ 47,337 | \$ 13,288 |
| <b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>            |           |           |
| Cash paid for income taxes                            | \$ 23,490 | \$ 23,777 |
| Cash paid for interest                                | \$ 2,181  | \$ 2,478  |
| <b>Non-cash financing activities:</b>                 |           |           |
| ESOP contributions                                    | \$ 2,319  | \$ 481    |

See notes to condensed consolidated financial statements.

**Table of Contents****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****September 30, 2006****UNAUDITED****1. Introduction and Overview**

ManTech International Corporation (depending on the circumstances, ManTech we our ours or us ) is a leading provider of innovative technologies and solutions for mission-critical national security programs for the Intelligence Community; the Departments of Defense, State, Homeland Security and Justice; the Space Community; and other federal government agencies. Our expertise includes systems engineering, systems integration, software development, enterprise security architecture, information assurance, intelligence operations support, network and critical infrastructure protection, information technology, communications integration and engineering support. With nearly 5,800 qualified employees, we operate in the United States and over 40 countries worldwide.

**2. Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and note disclosures normally included in the annual financial statements, prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted pursuant to those rules and regulations. We recommend that you read these unaudited condensed consolidated financial statements in conjunction with the financial statements and related notes included in our annual report on Form 10-K for the fiscal year ended December 31, 2005, previously filed with the SEC. We believe that the unaudited condensed consolidated financial statements in this Form 10-Q reflect all adjustments that are necessary to fairly present the financial position, results of operations and cash flows for the interim periods. The results of operations for such interim periods are not necessarily indicative of the results that can be expected for the full year. Certain reclassifications have been made to previously reported balances to conform to the current period presentation.

**3. Earnings Per Share**

Basic earnings per share have been computed by dividing net income by the weighted average number of common shares outstanding during each period. Shares issued during the period and shares re-acquired during the period, if any, are weighted for the portion of the period for which they were outstanding. Diluted earnings per share have been computed in a manner consistent with that of basic earnings per share, while giving effect to all potentially dilutive common shares that were outstanding during each period. The weighted average number of common shares outstanding is computed as follows:

|  | <b>Three Months Ended September 30,</b> |             | <b>Nine Months Ended September 30,</b> |             |
|--|---|-------------|--|-------------|
|  | <b>2006</b>                             | <b>2005</b> | <b>2006</b>                            | <b>2005</b> |
| Basic weighted average common shares outstanding   | 33,598,476                              | 32,955,258  | 33,389,961                             | 32,753,215  |
| Effect of potential exercise of stock options      | 371,334                                 | 522,555     | 418,164                                | 468,347     |
| Diluted weighted average common shares outstanding | 33,969,810                              | 33,477,813  | 33,808,125                             | 33,221,562  |

For the three months ended September 30, 2006 and 2005, options to purchase 719,857 and 1,304 shares, respectively, weighted for the portion of the period for which they were outstanding, were outstanding but not included in the computation of diluted earnings per share because the options effect would have been anti-dilutive. For the nine months ended September 30, 2006 and 2005, options to purchase 560,697 and 45,077 shares, respectively, weighted for the portion of the period for which they were outstanding, were outstanding but not included in the computation of diluted earnings per share because the options effect would have been anti-dilutive. For the nine months ended September 30, 2006 and September 30, 2005, shares issued from the exercise of stock options were 527,795 and 523,607, respectively.

**Table of Contents****4. Stock-Based Compensation**

**Stock Option Plan** In June 2006, the Company's stockholders approved our 2006 Management Incentive Plan (the Plan), which was designed to enable us to attract, retain and motivate key employees. The Plan amended and restated the Company's Management Incentive Plan that was approved by the Company's stockholders prior to the initial public offering for 2002 (the 2002 Plan). In connection with the creation of the Plan, all options outstanding under the 2002 Plan and the ManTech International Corporation 1995 Long-Term Incentive Plan were assumed. Awards granted under the Plan are settled in shares of Class A common stock. At the beginning of each year, the Plan provides that the number of shares available for issuance automatically increases by an amount equal to one and one-half percent of the total number of shares of Class A and Class B common stock outstanding on December 31st of the previous year. On January 2, 2006, 496,224 shares were added to the Plan. The 2006 Plan authorizes the issuance of an additional 1,500,000 shares in addition to the shares authorized under the 2002 Plan. Through September 30, 2006, the aggregate number of shares of our common stock authorized for issuance under the Plan was 6,284,187. Through September 30, 2006, 1,599,813 shares of our Class A common stock have been issued as a result of the exercise of the options granted under the Plan. The Plan expires in June 2016.

The Plan is administered by the compensation committee of our board of directors, along with its delegates. Subject to the express provisions of the Plan, the committee has broad authority to administer and interpret the Plan, including the discretion to determine the exercise price, vesting schedule, contractual life and the number of shares to be issued.

We typically issue options that vest in three equal installments, beginning on the first anniversary of the date of grant. Prior to January 1, 2006, we issued options under the 2002 Plan that typically expired ten years after the date of grant. Under the terms of the Plan, the contractual life of the option grants may not exceed eight years. During the nine months ended September 30, 2006, we issued options that expire five years from the date of grant. The Company expects that it will continue to issue options that expire five years from the date of grant for the foreseeable future.

**Adoption of SFAS No. 123R** In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), *Share-Based Payment*, which requires compensation costs related to share-based payment transactions to be recognized in financial statements. SFAS No. 123R eliminates the intrinsic value method of accounting available under Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, which generally resulted in no compensation expense being recorded in the financial statements related to the grant of stock options to employees if certain conditions were met.

Effective January 1, 2006, we adopted SFAS No. 123R using the modified prospective method. Under this method, compensation costs for all awards granted after the date of adoption and the unvested portion of previously granted awards will be measured at an estimated fair value and included in operating expenses or capitalized as appropriate over the vesting period during which an employee provides service in exchange for the award. Accordingly, prior period amounts presented have not been restated to reflect the adoption of SFAS No. 123R.

As a result of adopting SFAS No. 123R, income from continuing operations for the three and nine months ended September 30, 2006 was reduced \$1.3 million and \$4.0 million pre-tax, respectively. The after-tax effect of adoption for the three and nine months ended September 30, 2006 was a reduction in net income of \$0.8 million and \$2.4 million. Basic and diluted earnings per share for the three months ended September 30, 2006 were reduced by \$0.02. Basic and diluted earnings per share for the nine months ended September 30, 2006 were reduced by \$0.07 and \$0.06, respectively.

Prior to the adoption of SFAS No. 123R, we reported tax benefits from the exercise of stock options as an operating cash flow in the consolidated statement of cash flows. In the period beginning January 1, 2006, excess tax benefits from the exercise of stock options are presented as a cash flow from financing activities. For the nine months ended September 30, 2006 and 2005, excess tax benefits from the exercise of stock options were \$2.6 million and \$1.9 million, respectively.

**Stock Compensation Expense** We have elected to continue straight line amortization of stock-based compensation expense over the requisite service period. Prior to the adoption of SFAS No. 123R, we recognized the effect of forfeitures in our pro forma disclosures as they occurred. In accordance with the new standard, we have estimated forfeitures and are only recording expense on shares we expect to vest. For the three and nine months ended September 30, 2006, we recorded \$1.4 million and \$4.1 million of stock-based compensation cost as general and administrative expense in our statement of operations, respectively. Forfeitures have been estimated at 10%. No compensation expense of employee's holding stock options, including stock compensation expense, was capitalized during the periods.

As of September 30, 2006, there was \$8.3 million of unrecognized compensation cost related to share-based compensation arrangements that we expect to vest. In accordance with SFAS No. 123R, this cost will be fully amortized within three years, with over half of the total amortization being recognized over the next twelve months.



**Table of Contents**

In prior periods, as permitted under Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*, we accounted for our stock-based compensation plan using the intrinsic value method under the recognition and measurement principles of APB Opinion No. 25. In accordance with the provisions of SFAS No. 148, *Accounting for Stock-Based Compensation – Transition and Disclosure*, the following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation for the three and nine months ended September 30, 2005.

| (in thousands)  | Three Months Ended<br>September 30,<br>2005 | Nine Months Ended<br>September 30,<br>2005 |
|---|---|--|
| Net income, as reported   | \$ 11,687                                   | \$ 33,756                                  |
| Add: stock-based compensation, included in net income as reported, net of related tax effects   | 4   | 13   |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (710)                                       | (2,226)                                    |
| Pro forma net income  | \$ 10,981                                   | \$ 31,543                                  |
| <b>Earnings per share:</b>  |   |  |
| Basic as reported   | \$ 0.35                                     | \$ 1.03                                    |
| Basic pro forma   | \$ 0.33                                     | \$ 0.96                                    |
| Diluted as reported   | \$ 0.35                                     | \$ 1.02                                    |
| Diluted pro forma   | \$ 0.33                                     | \$ 0.95                                    |

**Fair Value Determination** Under SFAS No. 123R, we have elected to continue using the Black-Scholes option pricing model to determine fair value of our awards on date of grant. We will reconsider the use of the Black-Scholes 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 under this model.

The following weighted-average assumptions were used for option grants during the nine months ended September 30, 2006:

**Expected Volatility.** The expected volatility of the options granted was estimated based upon historical volatility of the Company's share price through weekly observations of the company's trading history. The expected volatility factor used for the options granted during the nine months ended September 30, 2006 was 42.11%.

**Expected Term.** The expected term of options granted during the nine months ended September 30, 2006 was determined under the simplified calculation provided in the SEC's Staff Accounting Bulletin No. 107 ((vesting term + original contractual term)/2). For all grants valued during the nine months ended September 30, 2006, the options had graded vesting over 3 years (33.3% of the options in each grant vest annually) and the contractual term was 5 years. Under this calculation, the expected life of our options granted during the nine months was 3.5 years.

**Risk-free Interest Rate.** The yield on zero-coupon U.S. Treasury strips was used to extrapolate a forward-yield curve. This term structure of future interest rates was then input into a numeric model to provide the equivalent risk-free rate to be used in the Black-Scholes model based on expected term of the underlying grants. The risk-free rate used in valuing options granted during the nine months ended September 30, 2006 was 4.68%.

**Dividend Yield.** The Black-Scholes valuation model requires an expected dividend yield as an input. We have not issued dividends in the past nor do we expect to issue dividends in the future. As such, the dividend yield used in our valuations for the nine months ended September 30, 2006 was zero.

**Stock Option Activity** During the nine months ended September 30, 2006, we granted stock options to purchase 579,500 shares of class A common stock at a weighted-average exercise price of \$30.30 per share, which reflects the fair market value of the shares on the date of grant. The weighted-average fair value of options granted during the nine months ended September 30, 2006, as determined under the Black-Scholes valuation model, was \$11.04. These options vest in 3 equal installments over 3 years and have a contractual term of 5 years. Option grants that vested during the nine months ended September 30, 2006 had a combined fair value of \$4.0 million.



**Table of Contents**

The following table summarizes the stock option activity for the nine months ended September 30, 2006:

|   | Number<br>of<br>Shares | Weighted Average<br>Exercise Price | Aggregate<br>Intrinsic Value<br>(in<br>thousands) |
|---|------------------------|------------------------------------|---|
| Shares under option, December 31, 2005    | 2,710,742              | \$ 20.38                           |   |
| Options granted                           | 579,500                | \$ 30.30                           |   |
| Options exercised                         | (527,795)              | \$ 19.43                           | \$ 6,937  |
| Options cancelled and expired             | (170,524)              | \$ 24.81                           |   |
| Shares under option, September 30, 2006   | 2,591,923              | \$ 20.86                           | \$ 27,256   |
| Options exercisable at September 30, 2006 | 1,103,956              | \$ 19.20                           | \$ 15,244   |

The following table summarizes nonvested stock options for the nine months ended September 30, 2006:

|   | Number<br>of<br>Shares | Weighted Average<br>Fair Value |
|---|------------------------|--------------------------------|
| Nonvested stock options at December 31, 2005      | 1,713,180              | \$ 6.96                        |
| Options granted                                   | 579,500                | \$ 11.04                       |
| Vested during period                              | (634,189)              | \$ 6.24                        |
| Options cancelled                                 | (170,524)              | \$ 8.22                        |
| Nonvested shares under option, September 30, 2006 | 1,487,967              | \$ 8.71                        |

Information concerning stock options outstanding and stock option exercisable at September 30, 2006:

| Range of Exercise Prices | Options<br>Outstanding | Weighted<br>Average<br>Remaining<br>Contractual Life<br>(years) | Weighted<br>Average<br>Exercise<br>Price |
|--------------------------|------------------------|---|--|
| \$15.56 19.82            | 977,079                | 7.3   | \$ 16.68                                 |
| \$20.45 23.11            | 511,425                | 6.9   | \$ 22.00                                 |
| \$23.95 33.85            | 1,103,419              | 6.4   | \$ 27.87                                 |
|                          | 2,591,923              |   |  |

| Range of Exercise Prices | Options<br>Exercisable | Weighted<br>Average<br>Remaining<br>Contractual Life<br>(years) | Weighted<br>Average<br>Exercise<br>Price |
|--------------------------|------------------------|---|--|
| \$15.56 19.82            | 641,408                | 7.1   | \$ 16.41                                 |
| \$20.45 23.11            | 317,476                | 6.7   | \$ 21.80                                 |
| \$23.95 33.85            | 145,072                | 8.4   | \$ 25.87                                 |



**5. Goodwill and Other Intangibles**

Effective January 1, 2002, we adopted SFAS No. 142, *Goodwill and Other Intangible Assets*. SFAS 142 requires, among other things, the discontinuance of goodwill amortization. Under SFAS 142, goodwill is to be reviewed at least annually for impairment; we have elected to perform this review annually during the second quarter each calendar year. These reviews resulted in no adjustments in goodwill.

**Table of Contents**

The components of goodwill and other intangibles are as follows:

|                                | September 30,<br>2006 | December 31,<br>2005 |
|--------------------------------|-----------------------|----------------------|
| Goodwill                       | \$ 237,854            | \$ 237,854           |
| Other intangibles              | 62,098                | 58,380               |
|                                | 299,952               | 296,234              |
| Less: Accumulated amortization | (37,771)              | (32,885)             |
|                                | \$ 262,181            | \$ 263,349           |

|  | September 30, 2006          |                             |                           | December 31, 2005           |                             |                        |
|--|-----------------------------|-----------------------------|---------------------------|-----------------------------|-----------------------------|------------------------|
|  | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Carrying<br>Amount | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net Carrying<br>Amount |
| Amortized intangible assets:               |                             |                             |                           |                             |                             |                        |
| Contract rights                            | \$ 37,230                   | \$ 12,435                   | \$ 24,795                 | \$ 37,230                   | \$ 9,875                    | \$ 27,355              |
| Capitalized software cost for sale         | 12,550                      | 9,294                       | 3,256                     | 12,072                      | 8,458                       | 3,614                  |
| Capitalized software cost for internal use | 12,318                      | 5,935                       | 6,383                     | 9,078                       | 4,445                       | 4,633                  |
|  | \$ 62,098                   | \$ 27,664                   | \$ 34,434                 | \$ 58,380                   | \$ 22,778                   | \$ 35,602              |

Aggregated amortization expense for the nine months ended September 30, 2006 and 2005 was \$4.9 million and \$4.0 million, respectively. We estimate that we will have the following amortization expense for the future periods indicated below (in thousands):

|   |          |
|---|----------|
| For the remaining three months ending December 31, 2006 | \$ 1,796 |
| For the years ending December 31:                       |          |
| 2007  | \$ 5,574 |
| 2008  | \$ 4,597 |
| 2009  | \$ 4,254 |
| 2010  | \$ 3,710 |
| 2011  | \$ 1,991 |

**6. Business Segment and Geographic Area Information**

We operate as one segment, delivering a broad array of information technology and technical services solutions under contracts with the U.S. government, state and local governments, and commercial customers. Our federal government customers 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 customer so long as that customer has independent decision-making and contracting authority within its organization. There were no sales to any customers within a single country (except for the United States) where the sales accounted for 10% or more of total revenue. We treat sales to U.S. government customers as sales within the United States regardless of where the services are performed. Substantially all assets of continuing operations were held in the United States for the periods ended September 30, 2006 and 2005. Revenues by geographic customer and the related percentages of total revenues for the periods ended September 30, 2006 and 2005, were as follows (in thousands):

|               | Three Months Ended September 30,<br>2006 | 2005       | Nine Months Ended September 30,<br>2006 | 2005       |
|---------------|--|------------|---|------------|
| United States | \$ 281,026                               | \$ 260,605 | \$ 838,881                              | \$ 715,494 |

Edgar Filing: MANTECH INTERNATIONAL CORP - Form 10-Q

|               |            |            |            |            |
|---------------|------------|------------|------------|------------|
| International | 2,669      | 1,826      | 7,585      | 3,806      |
|               | \$ 283,695 | \$ 262,431 | \$ 846,466 | \$ 719,300 |
| United States | 99.1%      | 99.3%      | 99.1%      | 99.5%      |
| International | 0.9%       | 0.7%       | 0.9%       | 0.5%       |
|               | 100.0%     | 100.0%     | 100.0%     | 100.0%     |

**Table of Contents**

During the three and nine months ended September 30, 2005, one contract in continuing operations, Regional Logistics Support to the Warfighter, exceeded 10% of our revenue. During the three months ended September 30, 2006, one contract in continuing operations, Countermine Support, exceeded 10% of our revenue and no contract exceeded 10% of our revenue for the nine months ended September 30, 2006. (in thousands):

|  | Three Months Ended September 30, |             |                   |             | Nine Months Ended September 30, |             |                   |             |
|--|----------------------------------|-------------|-------------------|-------------|---------------------------------|-------------|-------------------|-------------|
|  | 2006                             | %           | 2005              | %           | 2006                            | %           | 2005              | %           |
| <b>Revenues from external customers:</b>     |                                  |             |                   |             |                                 |             |                   |             |
| Regional Logistics Support to the Warfighter | \$ 16,926                        | 6%          | \$ 32,185         | 12%         | \$ 71,638                       | 8%          | \$ 80,544         | 11%         |
| Countermine Support                          | 36,548                           | 13%         |                   | 0%          | 63,865                          | 8%          |                   | 0%          |
| All other contracts                          | 230,221                          | 81%         | 230,246           | 88%         | 710,963                         | 84%         | 638,756           | 89%         |
| <b>ManTech Consolidated</b>                  | <b>\$ 283,695</b>                | <b>100%</b> | <b>\$ 262,431</b> | <b>100%</b> | <b>\$ 846,466</b>               | <b>100%</b> | <b>\$ 719,300</b> | <b>100%</b> |
| <b>Gross profit:</b>                         |                                  |             |                   |             |                                 |             |                   |             |
| Regional Logistics Support to the Warfighter | \$ 2,195                         | 5%          | \$ 3,772          | 8%          | \$ 8,565                        | 6%          | \$ 9,593          | 8%          |
| Countermine Support                          | 2,265                            | 5%          |                   | 0%          | 4,327                           | 3%          |                   | 0%          |
| All other contracts                          | 43,696                           | 91%         | 42,399            | 92%         | 131,349                         | 91%         | 117,577           | 92%         |
| <b>ManTech Consolidated</b>                  | <b>\$ 48,156</b>                 | <b>100%</b> | <b>\$ 46,171</b>  | <b>100%</b> | <b>\$ 144,241</b>               | <b>100%</b> | <b>\$ 127,170</b> | <b>100%</b> |
| <b>Receivables:</b>                          |                                  |             |                   |             |                                 |             |                   |             |
| Regional Logistics Support to the Warfighter |                                  |             |                   |             | \$ 6,054                        | 3%          | \$ 33,422         | 14%         |
| Countermine Support                          |                                  |             |                   |             | 12,133                          | 6%          |                   | 0%          |
| All other contracts                          |                                  |             |                   |             | 187,550                         | 91%         | 202,589           | 86%         |
| <b>ManTech Consolidated</b>                  |                                  |             |                   |             | <b>\$ 205,737</b>               | <b>100%</b> | <b>\$ 236,011</b> | <b>100%</b> |

Disclosure items required under SFAS No. 131 including interest revenue, interest expense, depreciation and amortization, costs for stock-based compensation programs and expenditures for segment assets are not applicable as we review those items on a consolidated basis.

**7. Revenues and Receivables**

We deliver a broad array of information technology and technical services solutions under contracts with the U.S. government, state and local governments, and commercial customers. Revenues from the U.S. government under prime contracts and subcontracts were approximately 97.8% and 98.2% of our total revenue for the nine months ended September 30, 2006 and 2005, respectively. The components of contract receivables are as follows:

|  | September 30, 2006 | December 31, 2005 |
|--|--------------------|-------------------|
| Billed receivables   | \$ 181,901         | \$ 204,793        |
| Unbilled receivables:  |                    |                   |
| Amounts billable   | 20,615             | 30,221            |
| Revenues recorded in excess of estimated contract value or funding         | 2,791              | 4,100             |
| Revenues recorded in excess of milestone billings on fixed price contracts | 4,427              | 3,737             |
| Retainage  | 2,064              | 1,935             |
| Allowance for doubtful accounts  | (6,061)            | (5,110)           |
|  | \$ 205,737         | \$ 239,676        |

Amounts billable consist principally of amounts to be billed within the next month. Revenues recorded in excess of contract value or funding are billable upon receipt of contractual amendments or other modifications. Revenues recorded in excess of milestone billings on fixed price

## Edgar Filing: MANTECH INTERNATIONAL CORP - Form 10-Q

contracts consist of amounts not expected to be billed within the next month. The retainage is billable upon completion of DCAA audit. At September 30, 2006, the amount of receivables that we expect to collect after one year is \$6.1 million.

**Table of Contents****8. Commitments and Contingencies**

Payments to us on cost-reimbursable contracts with the U.S. government are provisional payments subject to adjustment upon audit by the DCAA. The majority of audits through 2002 and 2003 have been completed and resulted in no material adjustments. The audits for 2002 through 2005 are not expected to have a material effect on the results of future operations.

In the normal course of business, we are involved in certain governmental and legal proceedings, claims and disputes, and have litigation pending under several suits. We believe that the ultimate resolution of these matters will not have a material effect on our financial position or results of operations.

**9. Acquisitions**

**Gray Hawk Systems, Inc.** On May 31, 2005, we completed the acquisition of 100 percent of outstanding shares of Gray Hawk Systems, Inc. ( Gray Hawk ). Gray Hawk provides a broad range of intelligence-related services to the homeland security, law enforcement, Intelligence Community and the Department of Defense markets. The acquisition was consummated pursuant to an Agreement and Plan of Merger, dated May 3, 2005, which provided for the merger of a wholly owned subsidiary of ManTech with and into Gray Hawk, with Gray Hawk surviving the merger and becoming a wholly owned subsidiary of ManTech ( ManTech Gray Hawk ).

We believe the Gray Hawk acquisition further solidifies our position as a supplier of services in the high-end intelligence market. It expands our presence in homeland security related missions and complements our high-end offerings for the Intelligence Community and Department of Defense. Gray Hawk s capabilities round-out ManTech s skills in the end-to-end, intelligence information processing cycle, and give ManTech access to new markets in national defense agencies, which we believe will become increasingly important as the Intelligence Reform Act of 2004 continues to unfold.

The purchase price for the acquisition was \$101.8 million in cash, which included transaction costs of \$0.3 million. The purchase price included the full payment of Gray Hawk s outstanding debt, repurchase of employee stock options by Gray Hawk, transaction costs and other related transaction expenses. Pursuant to the Merger Agreement, and as security for the Gray Hawk shareholders indemnification obligations, an escrow account in an amount equal to 10% of the adjusted purchase price was established to be used in satisfying certain indemnification obligations of the shareholders of Gray Hawk. As of September 30, 2006, all but \$0.3 million has been disbursed. Of the disbursed escrow amount, \$0.1 million was paid to the Company with the balance going to Gray Hawk Shareholders. Assuming we continue to produce adequate levels of taxable income, \$72.9 million of the \$75.4 million in goodwill will be deducted for tax purposes over 15 years.

*Purchase Price Allocation*

The acquisition has been accounted for as a business combination. Under business combination accounting, the total purchase price was allocated to Gray Hawk s net tangible and identifiable intangible assets based on their estimated fair values as of May 31, 2005, as set forth below. The excess of the purchase price over the net tangible and identifiable intangible assets, as determined by a third party valuation firm, was recorded as goodwill. Recognition of goodwill is largely attributed to the highly skilled employees of Gray Hawk and the value paid for companies in this business. The final aspect of the purchase agreement which is not yet finalized relates to Gray Hawk shareholders indemnification obligations of \$0.3 million for uncollected receivables and tax refund payments.

**(in thousands)**

|   |         |
|---|---------|
| Cash                                      | \$ 608  |
| Accounts receivable                       | 18,584  |
| Prepaid expenses and other current assets | 455     |
| Fixed assets                              | 799     |
| Other assets                              | 284     |
| Intangible assets                         | 15,650  |
| Goodwill                                  | 75,389  |
| Accounts payable                          | (4,345) |
| Payroll liabilities                       | (3,576) |
| Deferred tax liability                    | (1,528) |
| Billings in excess of revenue earned      | (321)   |
| Other liabilities                         | (190)   |

|                      |            |
|----------------------|------------|
| Total purchase price | \$ 101,809 |
|----------------------|------------|

**Table of Contents***Intangible Assets*

In allocating the purchase price, we considered, among other factors, our intention for future use of acquired assets, analyses of historical financial performance and estimates of future performance of Gray Hawk's contracts. Our fair value of intangible assets was based, in part, on a valuation completed by independent appraisers using an income approach and estimates and assumptions provided by management. The following table sets forth the components of intangible assets associated with the acquisition at May 31, 2005 (in thousands):

|                        | Fair Value | Estimated Useful Life |
|------------------------|------------|-----------------------|
| Backlog                | \$ 5,450   | 6 years               |
| Customer Relationships | \$ 7,200   | 20 years              |
| Intellectual Property  | \$ 3,000   | 7 years               |
| Total                  | \$ 15,650  |                       |

Customer contracts and related relationships represent the underlying relationships and agreements with Gray Hawk's existing customers. Intangible assets are being amortized using the straight-line method.

*Pro Forma Financial Information*

The unaudited financial information in the table below summarizes the combined results of operations of ManTech and Gray Hawk, on a pro forma basis, as though the companies had been combined as of the beginning of each of the periods presented. The pro forma financial information is presented for informational purposes only and is not indicative of the results of operations that would have been achieved if the Acquisition and borrowings under our Credit Agreement (see Note 10) had taken place at the beginning of each of the periods presented. The pro forma financial information for September 30, 2005 includes the business combination accounting effect on historical ManTech for amortization charges from acquired intangible assets, interest expense at our current level of debt, and the related tax effects.

The unaudited pro forma financial information for the nine months ended September 30, 2005 combines the historical results for ManTech and Gray Hawk for those periods. The financial information for the nine months ended September 30, 2006 is as reported in our consolidated statements of income (in thousands).

|  | Nine Months Ended September 30, |            |
|--|---------------------------------|------------|
|  | 2006 (a)                        | 2005       |
| Revenue  | \$ 846,466                      | \$ 750,225 |
| Income from continuing operations-net of taxes | \$ 40,303                       | \$ 37,334  |
| Net Income                                     | \$ 36,782                       | \$ 33,722  |
| Diluted earnings per share                     | \$ 1.09                         | \$ 1.02    |

**(a) As reported****10. Debt**

We currently have a Credit and Security Agreement with Citizens Bank of Pennsylvania. The agreement initially provides for a \$125 million credit facility that can be increased to \$200 million. The maturity date of the agreement is February 25, 2009. Under the agreement, we are required to maintain specified financial covenants relating to asset coverage, fixed charge coverage, and debt coverage. The agreement also places limitations on additional borrowings, mergers, and related-party transactions, payment of dividends, and contains limitations with respect to capital expenditures. Borrowings under the agreement are collateralized by our assets and bear interest at the London Inter-Bank Offer Rate (LIBOR), or the lender's base rate, plus market-rate spreads that are determined based on a company leverage ratio calculation. As of September 30, 2006, we were in compliance with all covenants under the credit facility.

We had \$0 and \$42.4 million outstanding on our credit facility at September 30, 2006 and December 31, 2005, respectively. The maximum available borrowing under the credit facility at September 30, 2006 was \$123.4 million. As of September 30, 2006, we were contingently liable



under letters of credit totaling \$1.6 million, which reduces our availability to borrow under our credit facility.

**Table of Contents****11. Discontinued Operations**

The Condensed Consolidated Financial Statements and related note disclosures reflect the ManTech MSM Security Services, Inc. (MSM) subsidiary as Long-Lived Assets to Be Disposed Of by Sale for all periods presented in accordance with SFAS No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets*. As such, MSM is classified as held for sale in the consolidated balance sheets and discontinued operations, net of applicable income taxes in the consolidated statements of income.

In 2005, we reached a final corporate determination to exit the personnel security investigation services business and discontinue operations at our MSM subsidiary. We reached the determination to sell our MSM subsidiary after we concluded that the MSM business no longer furthered our long-term strategic objectives. We intend to sell MSM as a going-concern and we are in continuing discussions with potential buyers. However, the sale has been delayed due to lower than expected results on a contract. This contract was expected to ramp up beginning in 2005 and provide considerable monthly revenues and profits for MSM. The level of anticipated growth did not occur. In July 2006, the customer procured new contracts for future work and MSM did not receive one of the new contracts. In addition, the customer determined that they would not exercise the follow on option periods on the existing contract. MSM has contracts with other customers and has recently received increased work on a continuing contract with one of these customers. We continue to market MSM and we believe there are potential buyers still interested in the acquisition of MSM and we are having continuing communications with such parties. We expect to complete a sale of MSM by the end of 2006. At December 31, 2005, we recorded a loss accrual of \$3.6 million on the valuation of these assets based on nonbinding offers received from potential buyers in early 2006. The loss accrual reflects the write-off of intangible assets including goodwill, net of taxes. The loss also reflects a valuation allowance of \$1.3 million for deferred state income tax assets related to net operating losses carried forward, which are not expected to be realized.

The following discloses the results of the discontinued operations of MSM for the three and nine months ended September 30, 2006 and 2005 (in thousands):

|                   | Three Months Ended September 30, |            | Nine Months Ended September 30, |            |
|-------------------|----------------------------------|------------|---------------------------------|------------|
|                   | 2006                             | 2005       | 2006                            | 2005       |
| Revenue           | \$ 4,118                         | \$ 1,570   | \$ 11,095                       | \$ 5,173   |
| Loss before taxes | \$ (1,807)                       | \$ (1,902) | \$ (5,825)                      | \$ (5,759) |
| Net Loss          | \$ (1,092)                       | \$ (1,167) | \$ (3,521)                      | \$ (3,481) |

The following is a summary of the assets and liabilities held for sale related to MSM at September 30, 2006 and December 31, 2005 (in thousands):

|                                       | September 30,<br>2006 | December 31,<br>2005 |
|---------------------------------------|-----------------------|----------------------|
| Receivables, net                      | \$ 3,524              | \$ 1,540             |
| Prepaid expenses and other            | 69                    | 67                   |
| Property and equipment                | 802                   | 710                  |
| Other assets                          | 1,430                 | 2,029                |
| <b>Total Assets</b>                   | <b>\$ 5,825</b>       | <b>\$ 4,346</b>      |
| Accounts payable and accrued expenses | \$ 586                | \$ 963               |
| Accrued salaries and related expenses | 464                   | 444                  |
| Billings in excess of revenue earned  | 2,711                 | 3,410                |
| Other liabilities                     | 55                    | 58                   |
| <b>Total Liabilities</b>              | <b>\$ 3,816</b>       | <b>\$ 4,875</b>      |

**Table of Contents****12. Gain on Disposal of an Operation**

On February 11, 2005, we sold our Mantech Environmental Technology, Inc ( METI ) subsidiary to another company, Alion Science and Technology Corporation. METI performs professional services including research and development in the fields of environmental and life sciences for the Environmental Protection Agency, the National Cancer Institute, the U.S. Air Force, and other federal government agencies. The financial terms of the arrangement included an all cash payment of \$7 million, which resulted in a pre-tax gain of approximately \$3.7 million, net of selling costs, in the first quarter of 2005. After the sale, we continue to provide professional services in the environmental area for various federal government agencies.

The following discloses the results of METI for the three and nine months ended September 30, 2005 (METI's results for 2005 are through February 11<sup>th</sup>) (in thousands):

|                     | <b>Nine Months Ended<br/>September 30,<br/>2005</b> |
|---------------------|---|
| Revenue             | \$ 1,379  |
| Income before taxes | \$ 55   |
| Net Income          | \$ 34   |

**13. Financial Guarantees**

Effective July 11, 2003, our lenders issued two letters of credit to Fianzas Guardiania Inbursa, S.A. (FGI) on behalf of GSE Systems, Inc (GSE). When the letters of credit were issued, we held an investment in GSE that was accounted for under the equity method. On October 21, 2003, we sold all of our equity interests in GSE to GP Strategies Corporation (GP Strategies) in exchange for a note with a principle amount of \$5.3 million. The note from GP Strategies bears interest at 5.0% per annum and is payable quarterly in arrears. Each year during the term of the note, we have an option to convert up to 20% of the original principal amount of the note into common stock of GP Strategies, but only in the event that GP Strategies' common stock is trading at \$10 per share or more. As of September 30, 2006, we have not converted any of the principal to GP Strategies' common stock.

During 2006, George J. Pedersen, our Chairman and Chief Executive Officer, beneficially owned shares and options of GSE stock representing less than 5% of GSE. In 2006, Mr. Pedersen served on GSE's board of directors and compensation committee.

The first letter of credit in support of an advance payment bond of approximately \$1.8 million, issued by FGI to a customer of GSE's power business was cancelled in March of 2005. The second letter of credit, which was in support of a performance bond of approximately \$1.3 million issued by FGI to the same customer, was cancelled in August 2006. In exchange for issuing the letters of credit, we received 100,000 warrants to purchase GSE's common stock at the market price of GSE's common stock as of the close of business on July 8, 2003, and received a 7% annual fee, payable on a quarterly basis, calculated on the total amount of the then-existing value of the letters of credit.

**14. Subsequent Events**

On October 5, 2006, we completed the acquisition of all outstanding shares of GRS Solutions, Inc. (GRS) for \$18.0 million in cash, subject to adjustment upon finalizing the closing balance sheet and certain shareholder indemnification obligations. The source of funds for the acquisition was our available cash.

GRS is a privately held company headquartered in Falls Church, VA providing specialized technical, operational and analytical services to the Intelligence Community. The acquisition improves our strategic position within the intelligence community and strengthens our capabilities in supporting counterterrorism/counterintelligence missions around the world. For its fiscal year ended September 30, 2006, GRS had revenues of approximately \$10.0 million.

The initial purchase price was \$18.0 million. As security for the GRS shareholders' indemnification obligations, an escrow account in an amount of \$1.8 million was established to be used in satisfying certain indemnification obligations of the shareholders of GRS. In addition, contingent consideration of \$2.0 million based on a defined performance objective was met subsequent to the initial purchase. The purchase price and contingent consideration will be allocated to the underlying assets and liabilities based on their estimated fair values.

## Edgar Filing: MANTECH INTERNATIONAL CORP - Form 10-Q

On October 31, 2006, we completed the sale of assets related to our NetWitness® business to the NetWitness Acquisition Corp. NetWitness® is a network forensics product used to analyze and model complex network traffic. The business consists of the software product, trademark, contracts, and a support staff of eleven people. The financial terms of the arrangement include a cash payment of \$2.0 million and an equity stake of less than 5% in the NetWitness Acquisition Corp.

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****Introduction and Overview**

We are a leading provider of innovative technologies and solutions for mission-critical national security programs for the Intelligence Community; the Departments of Defense, State, Homeland Security and Justice; the Space Community; and other U.S. federal government agencies. Our expertise includes systems engineering, systems integration, software services, enterprise architecture, information assurance and security architecture, intelligence operations and analysis support, network and critical infrastructure protection, information operations and computer forensics, information technology, communications integration and engineering support. With nearly 5,800 highly qualified employees, we operate in the United States and over 40 countries worldwide.

We derive revenue primarily from contracts with U.S. government agencies that are focused on national security and as a result, funding for our programs is generally linked to trends in U.S. government spending in the areas of defense, intelligence and homeland security. Leading up to and following the terrorist events of September 11, 2001, the U.S. government substantially increased its overall defense, intelligence and homeland security budgets.

We recommend that you read this discussion and analysis in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations included in our annual report on Form 10-K for the fiscal year ended December 31, 2005, previously filed with the SEC.

**Three Months Ended September 30, 2006 Compared to the Three Months Ended September 30, 2005**

|   | Consolidated Statements of Operations |            |             |         |                         |         |
|---|---------------------------------------|------------|-------------|---------|-------------------------|---------|
|   | Three Months Ended September 30,      |            | 2006        |         | Period to Period Change |         |
|   | 2006                                  | 2005       | 2006        | 2005    | 2005 to 2006            |         |
|   | Dollars                               |            | Percentages | Dollars | Percent                 |         |
|   | (dollar amounts in thousands)         |            |             |         |                         |         |
| <b>REVENUE</b>  | \$ 283,695                            | \$ 262,431 | 100.0%      | 100.0%  | \$ 21,264               | 08.1%   |
| <b>COST OF SERVICES</b>   | 235,539                               | 216,260    | 83.0%       | 82.4%   | 19,279                  | 08.9%   |
| <b>GROSS PROFIT</b>   | 48,156                                | 46,171     | 17.0%       | 17.6%   | 1,985                   | 04.3%   |
| <b>COSTS AND EXPENSES:</b>  |                                       |            |             |         |                         |         |
| General & administration  | 22,951                                | 22,327     | 08.1%       | 08.5%   | 624                     | 02.8%   |
| Depreciation & amortization   | 2,191                                 | 2,008      | 00.8%       | 00.8%   | 183                     | 09.1%   |
| <b>Total costs and expenses:</b>                                      | 25,142                                | 24,335     | 08.9%       | 09.3%   | 807                     | 03.3%   |
| <b>INCOME FROM CONTINUING OPERATIONS:</b>                             | 23,014                                | 21,836     | 08.1%       | 08.3%   | 1,178                   | 05.4%   |
| Interest (expense), net   | (291)                                 | (1,120)    | 00.1%       | 00.4%   | 829                     | -74.0%  |
| Equity in earnings of affiliates                                      |                                       | 157        | 00.0%       | 00.1%   | (157)                   | -100.0% |
| Other income (expense), net   | 21                                    | (52)       | 00.0%       | 00.0%   | 73                      | 140.4%  |
| <b>INCOME BEFORE PROVISION FOR INCOME TAXES AND MINORITY INTEREST</b> | 22,744                                | 20,821     | 08.0%       | 07.9%   | 1,923                   | 09.2%   |
| Provision for income taxes  | (8,962)                               | (7,833)    | 03.2%       | 03.0%   | (1,129)                 | 14.4%   |
| Minority interest   |                                       | (3)        | 00.0%       | 00.0%   | 3                       | -100.0% |
| <b>INCOME FROM CONTINUING OPERATIONS - net of taxes</b>               | 13,782                                | 12,985     | 04.9%       | 04.9%   | 797                     | 06.1%   |
| (Loss) income from discontinued operations-net of taxes               | (1,092)                               | (1,298)    | 00.4%       | 00.5%   | 206                     | -15.9%  |
| <b>NET INCOME</b>   | \$ 12,690                             | \$ 11,687  | 04.5%       | 04.5%   | \$ 1,003                | 08.6%   |



---

**Table of Contents***Revenues*

Revenues increased 8.1% to \$283.7 million for the three months ended September 30, 2006, compared to \$262.4 million for the same period in 2005. This increase is partially attributable to forward deployment support in Iraq and Afghanistan and increased work in the Intelligence Community. The loss of a Department of State contract as of June 30, 2006 slowed our growth in this quarter by approximately \$7.3 million as compared to the same period in 2005.

*Cost of services*

Cost of services increased 8.9% to \$235.5 million for the three months ended September 30, 2006, compared to \$216.3 million for the same period in 2005. As a percentage of revenues, cost of services increased 0.6%, to 83.0% for the three months ended September 30, 2006 compared to 82.4% for the same period in 2005. The increase in costs of services is largely attributable to increased purchases of subcontractors and equipment and materials used in the performance of our contracts. Direct labor costs, which includes applicable fringe benefit and overhead, was down slightly quarter over quarter. This decrease was primarily due to a reduction in our employee benefit cost. As a percentage of revenues, direct labor costs decreased 3.8% to 43.8% for the three months ended September 30, 2006 compared to 47.6% for the same period in 2005 due primarily to the increase in cost and related revenue from subcontractors and equipment and materials. For the three months ended September 30, 2006, other direct costs increased by 21.7% over the same quarter in 2005, from \$91.4 million to \$111.2 million, which reflects the increase in purchases of subcontractors and equipment and materials, as noted above. As a percentage of revenues, other direct costs increased from 34.8% for the three months ended September 30, 2005 to 39.2% for the same period in 2006.

*Gross profit*

Gross profit increased 4.3% to \$48.2 million for the three months ended September 30, 2006, compared to \$46.2 million for the same period in 2005. Gross profit margin was 17.0% for the three months ended September 30, 2006, compared to 17.6% for the same period in 2005. The decrease in gross profit margin is primarily due to a less profitable mix of reimbursable items including subcontractors and material purchases which increased cost of services as a percentage of revenue.

*General and administrative*

General and administrative expenses increased 2.8% to \$23.0 million for the three months ended September 30, 2006, compared to \$22.3 million for the same period in 2005. As a percentage of revenues, general and administrative expenses decreased to 8.1% from 8.5% for the three months ended September 30, 2006 and 2005, respectively. The increase in expense during the three months ended September 30, 2006 resulted primarily from the adoption of SFAS No. 123R. This increase was partially offset by a decrease in bid and proposal spending. Bid and proposal spending was higher in 2005 due to several key contracts being recompleted. Under SFAS No. 123R, share-based payments not fully vested as of January 1, 2006 and those granted after January 1, 2006 are measured at estimated fair value and included as compensation expense over the periods service is provided. For the three months ended September 30, 2006, we recognized \$1.3 million in compensation costs in accordance with SFAS No. 123R. Excluding the impact of SFAS No. 123R, general and administrative expense as a percentage of revenue was 7.6% for the three months ended September 30, 2006. The lower percentage reflects management's efforts to improve operating efficiency even though revenues increased by 8.1%.

*Depreciation and amortization*

Depreciation and amortization expense increased 9.1% to \$2.2 million for the three months ended September 30, 2006, compared to \$2.0 million for the same period in 2005. The increase was primarily due to the additional amortization of intangibles and an increase in leasehold improvements related to new office space and general improvements.

*Interest expense, net*

Interest expense, net decreased 74.0% to \$0.3 million for the three months ended September 30, 2006, compared with \$1.1 million for the same period in 2005. The decrease in interest expense, net is a result of paying off our line of credit and higher interest income due to increased cash on hand for the period ended September 30, 2006. The average levels of indebtedness were approximately \$29.6 million and \$81.0 million, in the three months ended September 30, 2006 and 2005, respectively. The higher average level of indebtedness in 2005 was due to our acquisition of Gray Hawk in May 2005. As we intend to use our credit facility to finance our acquisition strategy, interest expense levels could increase with the acquisition of other operations.

*Net income*

## Edgar Filing: MANTECH INTERNATIONAL CORP - Form 10-Q

Net income increased 8.6% to \$12.7 million for the three months ended September 30, 2006, compared to \$11.7 million for the same period in 2005. The increase is a result of higher revenue, increased income from continuing operations and reduced interest expense, net. Our losses in discontinued operations decreased due to higher revenue from increased case completion at our MSM subsidiary. Our effective tax rate for the three months ended September 30, 2006 and 2005 was 39.4% and 37.6%, respectively.



**Table of Contents***Nine Months Ended September 30, 2006 Compared to the Nine Months Ended September 30, 2005*

|   | Consolidated Statements of Operations |            |             |         |                         |         |
|---|---------------------------------------|------------|-------------|---------|-------------------------|---------|
|   | Nine Months Ended September 30,       |            | 2006        |         | Period to Period Change |         |
|   | 2006                                  | 2005       | 2006        | 2005    | 2005 to 2006            |         |
|   | Dollars                               |            | Percentages | Dollars | Percent                 |         |
|   | (dollar amounts in thousands)         |            |             |         |                         |         |
| <b>REVENUE</b>  | \$ 846,466                            | \$ 719,300 | 100.0%      | 100.0%  | \$ 127,166              | 17.7%   |
| <b>COST OF SERVICES</b>   | 702,225                               | 592,130    | 83.0%       | 82.3%   | 110,095                 | 18.6%   |
| <b>GROSS PROFIT</b>   | 144,241                               | 127,170    | 17.0%       | 17.7%   | 17,071                  | 13.4%   |
| <b>COSTS AND EXPENSES:</b>  |                                       |            |             |         |                         |         |
| General & Administration  | 69,731                                | 62,510     | 08.2%       | 08.7%   | 7,221                   | 11.6%   |
| Depreciation & amortization   | 6,327                                 | 5,147      | 00.7%       | 00.7%   | 1,180                   | 22.9%   |
| <b>Total costs and expenses:</b>                                      | 76,058                                | 67,657     | 09.0%       | 09.4%   | 8,401                   | 12.4%   |
| <b>INCOME FROM CONTINUING OPERATIONS:</b>                             | 68,183                                | 59,513     | 08.1%       | 08.3%   | 8,670                   | 14.6%   |
| Interest (expense), net   | (1,684)                               | (1,956)    | 00.2%       | 00.3%   | 272                     | -13.9%  |
| Equity in earnings of affiliates                                      |                                       | 435        | 00.0%       | 00.1%   | (435)                   | -100.0% |
| Gain on disposal of an operation                                      |                                       | 3,698      | 00.0%       | 00.5%   | (3,698)                 | -100.0% |
| Other income (expense), net   | 8                                     | (228)      | 00.0%       | 00.0%   | 236                     | 103.5%  |
| <b>INCOME BEFORE PROVISION FOR INCOME TAXES AND MINORITY INTEREST</b> | 66,507                                | 61,462     | 07.9%       | 08.5%   | 5,045                   | 08.2%   |
| Provision for income taxes  | (26,204)                              | (24,085)   | 03.1%       | 03.3%   | (2,119)                 | 08.8%   |
| Minority interest   |                                       | (9)        | 00.0%       | 00.0%   | 9                       | -100.0% |
| <b>INCOME FROM CONTINUING OPERATIONS - net of taxes</b>               | 40,303                                | 37,368     | 04.8%       | 05.2%   | 2,935                   | 07.9%   |
| (Loss) income from discontinued operations-net of taxes               | (3,521)                               | (3,612)    | 00.4%       | 00.5%   | 91                      | -02.5%  |
| <b>NET INCOME</b>   | \$ 36,782                             | \$ 33,756  | 04.3%       | 04.7%   | \$ 3,026                | 09.0%   |

*Revenues*

Revenues increased 17.7% to \$846.5 million for the nine months ended September 30, 2006, compared to \$719.3 million for the same period in 2005. This increase is partially attributable to forward deployment support in Iraq and Afghanistan and increased work in the Intelligence Community. Also contributing to the increase was three full quarters of revenues from our acquisition of Gray Hawk Systems, Inc. ( Gray Hawk ) on May 31, 2005. Gray Hawk accounted for \$37.6 million of our increase in revenue period over period.

*Cost of services*

Cost of services increased 18.6% to \$702.2 million for the nine months ended September 30, 2006, compared to \$592.1 million for the same period in 2005. As a percentage of revenues, cost of services increased 0.7%, to 83.0% for the nine months ended September 30, 2006 compared to 82.3% for the same period in 2005. This increase was due to larger purchases of equipment and materials directly for contracts and the use of subcontractors in support of our contracts. Direct labor costs, which include applicable fringe benefits and overhead, increased by 11.3% primarily due to the addition of Gray Hawk and the growth of our business. As a percentage of revenues, direct labor costs decreased 2.6% to 45.6% for the nine months ended September 30, 2006 compared to 48.2% for the same period in 2005. For the nine months ended September 30, 2006, other direct costs increased by 28.9% over the same period in 2005, from \$245.5 million to \$316.5 million, which reflects the increase in purchases of subcontractors and equipment and materials, as noted above. As a percentage of revenues, other direct costs increased from 34.1% for the nine months ended September 30, 2005 to 37.4% for the same period in 2006.

*Gross profit*

## Edgar Filing: MANTECH INTERNATIONAL CORP - Form 10-Q

Gross profit increased 13.4% to \$144.2 million for the nine months ended September 30, 2006, compared to \$127.2 million for the same period in 2005. Gross profit margin was 17.0% for the nine months ended September 30, 2006, compared to 17.7% for the same period in 2005. The decrease in gross profit margin is primarily due to a less profitable mix of reimbursable items including subcontractors and material purchases which increased cost of services as a percentage of revenue.

---

## **Table of Contents**

### *General and administrative*

General and administrative expenses increased 11.6% to \$69.7 million for the nine months ended September 30, 2006, compared to \$62.5 million for the same period in 2005. As a percentage of revenues, general and administrative expenses decreased to 8.2% from 8.7% for the nine months ended September 30, 2006 and 2005, respectively. The increase in expense during the nine months resulted primarily from the adoption of SFAS No. 123R and the addition of Gray Hawk in May 2005. This increase was partially offset by a decrease in bid and proposal spending. Under SFAS No. 123R, share-based payments not fully vested as of January 1, 2006 and those granted in the nine months ended September 30, 2006 are measured at estimated fair value and included as compensation expense over the periods service is provided. For the nine months ended September 30, 2006, we recognized \$4.0 million in compensation costs in accordance with SFAS No. 123R. Excluding the impact of SFAS No. 123R, general and administrative expense as a percentage of revenue was 7.8% for the nine months ended September 30, 2006. The lower percentage reflects management's efforts to improve operating efficiency even though revenues increased by 17.7%.

### *Depreciation and amortization*

Depreciation and amortization expense increased 22.9% to \$6.3 million for the nine months ended September 30, 2006, compared to \$5.1 million for the same period in 2005. The increase was primarily due to the additional amortization of intangibles from the Gray Hawk acquisition and an increase in leasehold improvements related to new office space and general improvements.

### *Interest expense, net*

Interest expense, net decreased 13.9% to \$1.7 million for the nine months ended September 30, 2006, compared with \$2.0 million for the same period in 2005. The decrease in interest expense is a result of decreased borrowing under our credit facility in 2006. The higher level of indebtedness in 2005 was due to our acquisition of Gray Hawk Systems in May 2005. As we intend to use our credit facility to finance our acquisition strategy, interest expense levels could increase with the acquisition of other operations.

### *Gain on disposal of an operation*

On February 11, 2005, we sold our Mantech Environmental Technology, Inc ( METI ) subsidiary to Alion Science and Technology Corporation. The sale generated a pre-tax gain of \$3.7 million in 2005. For additional information see [Gain on Disposal of an Operation](#), below.

### *Net income*

Net income increased 9.0% to \$36.8 million for the nine months ended September 30, 2006, compared to \$33.8 million for the same period in 2005. The increase is a result of higher revenue and increased income from continuing operations. In addition, we recorded a \$1.8 million after-tax gain recorded in 2005 on the sale of METI. Our effective tax rate for the nine months ended September 30, 2006 and 2005 was 39.4% and 39.2%, respectively.

## **Backlog**

At September 30, 2006 and December 31, 2005, our backlog was \$2.7 billion and \$2.3 billion, respectively, of which \$504 million and \$467 million, respectively, was funded backlog. At September 30, 2005, our backlog was \$1.9 billion, of which \$439 million was funded backlog. Backlog and funded backlog represent estimates that we calculate on a consistent basis. Additional information on how we determine backlog is included in our annual report on Form 10-K for the fiscal year ended December 31, 2005, previously filed with the SEC. The increase in backlog was primarily attributable to the award for work currently under the Regional Support of the War fighter contract listed in footnote 6 of the financial statements.

## **Effects of Inflation**

We generally have been able to price our contracts in a manner to accommodate the rates of inflation experienced in recent years. Under our time and materials contracts, labor rates are usually adjusted annually by predetermined escalation factors. Our cost reimbursable contracts automatically adjust for changes in cost. Under our fixed-price contracts, we include a predetermined escalation factor, but generally, we have not been adversely affected by inflation.

## **Liquidity and Capital Resources**

## Edgar Filing: MANTECH INTERNATIONAL CORP - Form 10-Q

Our primary liquidity needs are the financing of working capital, capital expenditures and acquisitions. Our primary source of liquidity is cash provided by operations and our \$125.0 million revolving credit facility. At September 30, 2006, we did not have an outstanding balance under our credit facility. At September 30, 2006, we were contingently liable under letters of credit totaling \$1.6 million, which reduces our ability to borrow under our credit facility. The maximum available borrowing under our

**Table of Contents**

credit facility at September 30, 2006 was \$123.4 million. Generally, cash provided by operating activities is adequate to fund our operations. Due to fluctuations in our cash flows and the growth in our operations, it is necessary from time to time to increase borrowings under our credit facility to meet cash demands. In the future, we may borrow greater amounts in order to finance acquisitions or new contract start ups.

***Net cash flows from operating activities***

| (in thousands)  | Nine months ended September 30, |                  |
|---|---------------------------------|------------------|
|   | 2006                            | 2005             |
| Cash provided by operating activities from continuing operations: | \$ 83,026                       | \$ 23,872        |
| Cash (used) provided by discontinued operations:                  | (5,881)                         | 14,137           |
| <b>Cash provided by operating activities:</b>                     | <b>\$ 77,145</b>                | <b>\$ 38,009</b> |

Cash provided by operating activities for the nine months ended September 30, 2006 was \$77.1 million, compared to \$38.0 million provided by operating activities for the nine months ended September 30, 2005. The increase in cash provided in 2006 was primarily due to the significant collections of receivables. The significant collections were the results of a very focused effort by management. In addition, net cash flows from operating activities was impacted by the adoption of SFAS No. 123R, which required the reclassification of excess tax benefits from the exercise of stock options from operating cash flows to financing cash flows. For the nine months ended September 30, 2005, discontinued operations provided \$14.1 million of cash inflow versus a net use of cash of \$5.9 million for the nine months ended September 30, 2006. Net cash inflow from discontinued operations in 2005 was primarily due to collections on our Defense Security Services contract of \$16.4 million.

***Net cash flows from investing activities***

| (in thousands)  | Nine months ended September 30, |                     |
|---|---------------------------------|---------------------|
|   | 2006                            | 2005                |
| Cash used in investing activities from continuing operations:   | \$ (5,708)                      | \$ (106,453)        |
| Cash used in investing activities from discontinued operations: | (125)                           | (355)               |
| <b>Cash used in investing activities:</b>                       | <b>\$ (5,833)</b>               | <b>\$ (106,808)</b> |

Cash used in investing activities was \$5.8 million for the nine months ended September 30, 2006, compared to a cash outflow of \$106.8 million for the same period in 2005. The cash outflow in 2006 is primarily the result of investments in property, plant, and equipment and internal-use software. For the same period in 2005, the cash outflow is primarily due to the acquisition of Gray Hawk in May of 2005 for \$101.2 million, net of cash acquired and final earnout payments related to our acquisition of IDS in 2003.

Subsequent to September 30, 2006, we acquired GRS Solutions, Inc for an initial purchase price of \$18.0 million in cash on October 5, 2006. In addition, on October 31, 2006 we sold assets related to our NetWitness® business for \$2.0 million in cash. For additional information, see Note 14 Subsequent Events in our condensed consolidated financial statements.

***Net cash flows from financing activities***

| (in thousands) | Nine months ended September 30, |      |
|----------------|---------------------------------|------|
|                | 2006                            | 2005 |

## Edgar Filing: MANTECH INTERNATIONAL CORP - Form 10-Q

|   |    |          |    |        |
|---|----|----------|----|--------|
| Cash (used) provided by financing activities: | \$ | (29,637) | \$ | 59,141 |
|---|----|----------|----|--------|

Cash used in financing activities was \$29.6 million for the nine months ended September 30, 2006, compared to cash provided by financing activities of \$59.1 million for the nine months ended September 30, 2005. The net cash used in the first nine months of 2006 resulted primarily from paying down our line of credit with cash provided from operations, \$42.4 million, offset by cash inflows from the exercise of stock options of \$10.3 million and the impact of SFAS No. 123R. SFAS 123R requires that excess tax benefits be shown as a cash inflow from financing activities. The net cash provided in the nine months ended September 30, 2005 resulted from proceeds from the exercise of stock options of \$9.2 million and use of our line of credit of \$50.0 million to finance our acquisition of Gray Hawk.

---

**Table of Contents****Credit Agreement**

We currently have a Credit and Security Agreement with Citizens Bank of Pennsylvania. The agreement initially provides for a \$125.0 million credit facility that can be increased to \$200.0 million. The maturity date of the agreement is February 25, 2009. Under the agreement, we are required to maintain specified financial covenants relating to asset coverage, fixed charge coverage, and debt coverage. The agreement also places limitations on additional borrowings, mergers, and related-party transactions, payment of dividends, and contains limitations with respect to capital expenditures. Borrowings under the agreement are collateralized by our assets and bear interest at the London Interbank Offered Rate (LIBOR), or the lender's base rate, plus market-rate spreads that are determined based on a company leverage ratio calculation. As of September 30, 2006, we were in compliance with all material covenants under the credit facility.

We believe the capital resources available to us under our credit facility and cash from our operations are adequate to fund our ongoing operations and to support the internal growth we expect to achieve for at least the next twelve months. We anticipate financing our external growth from acquisitions and our longer-term internal growth through one or more of the following sources: cash from operations; additional borrowing; issuance of equity; use of the credit facility; or a refinancing of our credit facility.

**Off-Balance Sheet Arrangements**

Effective June 20, 2003, our lenders issued two letters of credit to Fianzas Guardiania Inbursa, S.A. (FGI) on behalf of GSE Systems, Inc. (GSE). As discussed in note 13 to our consolidated financial statements, prior to the sale of these investments on October 21, 2003, we held common and preferred stock in GSE and accounted for this investment using the equity method.

The first letter of credit, which was cancelled in March 2005, was in support of an advance payment bond of approximately \$1.8 million, issued by FGI to a customer of GSE's power business and had a term of 30 months. The second letter of credit, which was in support of a performance bond of approximately \$1.3 million issued by FGI to the same customer, was cancelled in August 2006. In exchange for issuing the letters of credit, we received 100,000 warrants to purchase GSE's common stock at the market price of GSE's common stock as of the close of business on July 8, 2003, and received a 7% annual fee, payable on a quarterly basis, calculated on the total amount of the then-existing value of the letters of credit.

During 2006, George J. Pedersen, our Chairman of the Board and Chief Executive Officer, beneficially owned shares and options of GSE stock representing less than 5% of GSE. In 2006, Mr. Pedersen served on GSE's board of directors and compensation committee.

**Gain on Disposal of an Operation**

On February 11, 2005, we sold our METI subsidiary to another company, Alion Science and Technology Corporation. METI performs research and development in the fields of environmental and life sciences for the Environmental Protection Agency, the National Cancer Institute, the U.S. Air Force, and other federal government agencies. The financial terms of the arrangement included an all cash payment of \$7 million, which resulted in a pre-tax gain of approximately \$3.7 million net of selling cost in the nine months ended September 30, 2005. Although we have sold METI, we continue to provide professional services in the environmental area for various federal government agencies.

**Discontinued Operations**

The Condensed Consolidated Financial Statements and related note disclosures reflect the ManTech MSM Security Services, Inc. (MSM) subsidiary as *Long-Lived Assets to Be Disposed Of by Sale* for all periods presented in accordance with SFAS No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets*. As such, MSM is classified as held for sale in the consolidated balance sheets and discontinued operations, net of applicable income taxes in the consolidated statements of income.

In 2005, we reached a final corporate determination to exit the personnel security investigation services business and discontinue operations at our MSM subsidiary. We reached the determination to sell our MSM subsidiary after we concluded that the MSM business no longer furthered our long-term strategic objectives. We intend to sell MSM as a going-concern and we are in continuing discussions with potential buyers. However, the sale has been delayed due to lower than expected results on a contract. This contract was expected to ramp up beginning in 2005 and provide considerable monthly revenues and profits for MSM. The level of anticipated growth did not occur. In July 2006, the customer procured new contracts for future work and MSM did not receive one of the new contracts. In addition, the customer determined that they would not exercise the follow on option periods on the existing contract. MSM has contracts with other customers and has recently received considerable increased work on a continuing contract with one of these customers. We believe this trend of additional customer demand will continue into the near future. We continue to market MSM and we believe there are potential buyers still interested in the acquisition of MSM and we are having continuing communications with such parties. We expect to complete a sale of MSM by the end of 2006. At December 31,

## Edgar Filing: MANTECH INTERNATIONAL CORP - Form 10-Q

2005, we recorded a loss accrual of \$3.6 million on the valuation of these assets based on nonbinding offers received from potential buyers in early 2006. The loss accrual reflects the write-off of intangible assets including goodwill, net of taxes. The loss also reflects a valuation allowance of \$1.3 million for deferred state income tax assets related to net operating losses carried forward, which are not expected to be realized.



**Table of Contents****Critical Accounting Estimates and Policies**

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and potentially result in materially different results under different assumptions and conditions. Application of these policies is particularly important to the portrayal of our financial condition and results of operations. The discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these consolidated financial statements requires management to make estimates and judgments that affect the reported amount of assets, liabilities, revenues and expenses. Actual results may differ from these estimates under different assumptions or conditions. Our significant accounting policies, including the critical policies listed below, are described in the notes to the condensed consolidated financial statements included in this report.

*Revenue Recognition and Cost Estimation*

We recognize revenue when persuasive evidence of an arrangement exists, services have been rendered, the contract price is fixed or determinable, and collectibility is reasonably assured. We have a standard internal process that we use to determine whether all required criteria for revenue recognition have been met.

Our revenues consist primarily of services provided by our employees, and to a lesser extent, the pass through of costs for materials and subcontract efforts under contracts with our customers. Cost of services consists primarily of compensation expenses for program personnel, the fringe benefits associated with this compensation, and other direct expenses incurred to complete programs, including cost of materials and subcontract efforts.

We derive the majority of our revenue from cost-plus-fixed-fee, cost-plus-award-fee, firm-fixed-price, or time-and-materials contracts. Revenues for cost-reimbursement contracts are recorded as reimbursable costs are incurred, including an estimated share of the applicable contractual fees earned. For performance-based fees under cost reimbursable contracts, that are subject to the provisions of Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* (SOP 81-1), we recognize the relevant portion of the expected fee to be awarded by the client at the time such fee can be reasonably estimated, based on factors such as our prior award experience and communications with the client regarding performance. For cost reimbursable contracts with performance-based fee incentives that are subject to the provisions of U.S. Securities and Exchange Commission Staff Accounting Bulletin No. 104, *Revenue Recognition (SAB104)*, we recognize the relevant portion of the fee upon customer approval. For time-and-material contracts, revenue is recognized to the extent of billable rates times hours delivered plus material and other reimbursable costs incurred. For long-term fixed-price production contracts, revenue is recognized at a rate per unit as the units are delivered, or by other methods to measure services provided. Revenue from other long-term fixed-price contracts is recognized ratably over the contract period or by other appropriate methods to measure services provided. Contract costs are expensed as incurred except for certain limited long-term contracts noted below. For long-term contracts which are specifically described in the scope section of American Institute of Certified Public Accountants ( AICPA ) Statement of Position ( SOP ) No. 81-1, *Accounting for Performance of Construction Type and Certain Production-Type Contracts*, or other appropriate accounting literature we apply the percentage of completion method. Under the percentage of completion method, income is recognized at a consistent profit margin over the period of performance based on estimated profit margins at completion of the contract. This method of accounting requires estimating the total revenues and total contract cost at completion of the contract. During the performance of long-term contracts, these estimates are periodically reviewed and revisions are made as required. The impact on revenue and contract profit as a result of these revisions is included in the periods in which the revisions are made. This method can result in the deferral of costs or the deferral of profit on these contracts. Because we assume the risk of performing a fixed-price contract at a set price, the failure to accurately estimate ultimate costs or to control costs during performance of the work could result, and in some instances has resulted, in reduced profits or losses for such contracts. Estimated losses on contracts at completion are recognized when identified. In certain circumstances, revenues are recognized when contract amendments have not been finalized.

*Goodwill*

Goodwill represents the excess of cost over the fair value of net tangible and identifiable intangible assets of acquired companies. Effective January 1, 2002, we adopted SFAS No. 142, and no longer amortize goodwill; rather, we review goodwill at least annually for impairment. We have elected to perform this review annually during second quarter of each calendar year and have determined no adjustments are necessary at this time. For acquisitions completed prior to the adoption of SFAS No. 141 and SFAS No. 142 on January 1, 2002, goodwill was amortized on a straight-line basis over periods ranging from two to twenty years.

---

## **Table of Contents**

### *Other Matters*

Our significant accounting policies, including the critical policies listed above, are described in the notes to the consolidated financial statements for the year ended December 31, 2005, included in our Annual Report on Form 10-K filed with the SEC on March 10, 2006.

### **Recent Accounting Pronouncements**

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), *Share-Based Payment*, which requires the compensation costs related to share-based payment transactions be recognized in financial statements. With limited exceptions, the amount of compensation will be measured based on the grant-date fair value of the equity instruments issued. Compensation cost will be recognized over the vesting period during which an employee provides service in exchange for the award. SFAS No. 123(R) was effective January 1, 2006 for the company. We have adopted the modified prospective method for reporting utilizing the Black-Scholes model for valuing our stock-based compensation on date of grant.

Information about the fair value of stock options under the Black-Scholes model and its pro forma impact on the Company's net earnings and earnings per share for the historical periods is illustrated in Note 4 of our financial statements under Stock-based Compensation disclosure.

In July 2006, the FASB issued Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes* an interpretation of FASB Statement No. 109, which clarifies the accounting for uncertainty in tax positions. FIN 48 seeks to reduce the diversity in accounting practices used in regards to uncertain tax positions by prescribing a recognition threshold and measurement criteria for benefits related to income taxes. The provisions of FIN 48 are effective for all reporting periods beginning after December 15, 2006. At this time, we are assessing the impact of the adoption of FIN 48 will have on our statement of financial position and statement of operations.

In September 2006, the FASB issued Statement No. 157 ( SFAS No. 157 ), *Fair Value Measurements* , which addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under generally accepted accounting principles. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. At this time, we are assessing the impact of the adoption of SFAS No. 157 will have on our statement of financial position and statement of operations.

### **Forward-Looking Statements**

This Quarterly Report on Form 10-Q contains forward-looking statements that involve substantial risks and uncertainties, many of which are outside of our control. ManTech believes these statements to be within the definition of the Private Securities Litigation Reform Act of 1995. You can identify these statements by forward-looking words such as *may, will, expect, intend, anticipate, believe, estimate,* similar words. You should read statements that contain these words carefully because they discuss our future expectations, make projections of our future results of operations or financial condition or state other forward-looking information. continue

Although forward-looking statements in this Quarterly Report reflect the good faith judgment of management, such statements can only be based on facts and factors currently known by us. Consequently, forward-looking statements are inherently subject to risks and uncertainties, and actual results and outcomes may differ materially from the results and outcomes discussed in or anticipated by the forward-looking statements. We believe that it is important to communicate our future expectations to our investors. However, there may be events in the future that we are not able to predict accurately or control. Factors that could cause actual results to differ materially from the results we anticipate include, but are not limited to, the following:

adverse changes in U.S. government spending priorities;

failure to retain existing U.S. government contracts, win new contracts or win recompetes;

uncertainties specifically related to discontinued operations, including our ability to sell or dispose of our MSM operations on terms that are favorable to us, or at all;

adverse results of U.S. government audits of our government contracts;

adverse effect of contract consolidations;

## **Table of Contents**

adverse changes in our mix of contract types;

additional risks and costs associated with complying with new laws and regulations relating to corporate governance issues;

risk of contract performance or termination;

failure to obtain option awards, task orders or funding under contracts;

failure to successfully integrate recently acquired companies or businesses into our operations or to realize any accretive or synergistic effects from such acquisitions;

failure to identify, execute or effectively integrate future acquisitions;

risks associated with complex U.S. government procurement laws and regulations; and

competition.

We urge you not to place undue reliance on these forward-looking statements, which speak only as of the date of this Quarterly Report. These and other risk factors are more fully described and discussed in our annual report on Form 10-K for the fiscal year ended December 31, 2005, previously filed with the SEC, those referenced in Item 1A of Part II below, and from time to time, in our other filings with the SEC. We undertake no obligation to revise or update any forward-looking statements in order to reflect any event or circumstance that may arise after the date of this Quarterly Report. We also suggest that you carefully review and consider the various disclosures made in this Quarterly Report that attempt to advise interested parties of the risks and factors that may affect our business, financial condition, results of operations and prospects.

### **Item 3. Quantitative and Qualitative Disclosure about Market Risk**

Our exposure to market risk relates to changes in interest rates for borrowings under our senior term loan and revolving credit facility. These borrowings bear interest at variable rates. As of September 30, 2006, we had no borrowings outstanding under our revolving credit facility. A hypothetical 10% increase in interest rates would have increased our interest expense for the three months ended September 30, 2006 by less than \$0.2 million.

We do not use derivative financial instruments for speculative or trading purposes. We invest our excess cash in short-term, investment grade, interest-bearing securities. Our investments are made in accordance with an investment policy approved by the board of directors. Under this policy, no investment securities can have maturities exceeding one year, and the average maturity of the portfolio cannot exceed 90 days.

### **Item 4. Controls and Procedures**

As of September 30, 2006, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer (our principal executive officer and principal financial officer, respectively), management evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 of the Exchange Act. Based upon this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective, as of the end of the period covered by this report, such that the information relating to us that is required to be disclosed in our reports filed with the SEC (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

There were no changes in our internal control over financial reporting during the Company's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.



---

**Table of Contents**

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

We are subject to certain legal proceedings, government audits, investigations, claims and disputes that arise in the ordinary course of our business. Like most large government defense contractors, our contract costs are audited and reviewed on a continual basis by an in-house staff of auditors from the Defense Contract Auditing Agency. In addition to these routine audits, we are subject from time to time to audits and investigations by other agencies of the federal government. These audits and investigations are conducted to determine if our performance and administration of our government contracts are compliant with contractual requirements and applicable federal statutes and regulations. An audit or investigation may result in a finding that our performance, systems and administration is compliant or, alternatively, may result in the government initiating proceedings against us or our employees, including administrative proceedings seeking repayment of monies, suspension and/or debarment from doing business with the federal government or a particular agency, or civil or criminal proceedings seeking penalties and/or fines. Audits and investigations conducted by the federal government frequently span several years.

Although we cannot predict the outcome of these and other legal proceedings, investigations, claims and disputes, based on the information now available to us, we do not believe the ultimate resolution of these matters, either individually or in the aggregate, will have a material adverse effect on our business, prospects, financial condition or operating results.

**Item 1A. Risk Factors**

Other than as set forth below, there have been no material changes from the risk factors disclosed in the Risk Factors section of the Company's Annual Report on Form 10-K for the year ended December 31, 2005. The risk factor stated below was disclosed on our Form 10-K and has been updated to reflect management's current expectation regarding the timing of the disposition of MSM.

*We may be exposed to liabilities or losses from operations that we have or will discontinue or otherwise sell, including our MSM subsidiary.*

In 2005, we reached a final corporate determination to exit the personnel security investigation (PSI) services business and discontinue operations at our MSM subsidiary. We intend to sell MSM as a going-concern and are in continuing discussions with potential buyers. We expect to complete a sale or other disposition of the MSM operations by the end of 2006; however, we cannot assure you that we will complete a transaction under the terms currently contemplated, or even at all. Similarly, we may incur unanticipated additional costs in connection with the sale or disposition of MSM. If we are not able to sell or dispose of MSM on the terms currently contemplated, our business, prospects, financial condition or operating results could be harmed.

In recent years, we have sold or wound down the operations of other businesses as well.

For more information on these discontinued operations, please see our current Form 10-K, *Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Discontinued Operations* and Note 16 to our consolidated financial statements. Our consolidated financial statements reflect, under the heading Discontinued Operations, our estimate of the net losses we expected from these operations through the date we estimated they would be disposed, and all losses expected to be realized upon the disposal of these operations. Even after the disposition of these businesses, we may continue to be exposed to some liabilities arising from their prior operations. Additionally, when we sell one of our subsidiaries, the operative contractual agreement may contain provisions that require us to indemnify the purchaser for certain liabilities that arose prior to the sale date but that are discovered afterwards. Even though these liabilities are often capped, until the indemnification period expires, we may continue to be exposed to such liabilities.

**Table of Contents**

**Item 6. Exhibits**

Exhibits required by Item 601 of Regulation S-K:

The following lists certain exhibits either filed herewith or filed with the SEC during the fiscal quarter ended September 30, 2006.

| <b>Exhibit No.</b> | <b>Description</b>  |
|--------------------|---|
| 31.1               | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.                             |
| 31.2               | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.                             |
| 32                 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended. |

---

Filed herewith

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**MANTECH INTERNATIONAL CORPORATION**

Date: November 6, 2006

By: /s/ GEORGE J. PEDERSEN  
Name: **George J. Pedersen**  
Title: **Chairman of the Board of Directors and Chief Executive Officer**

Date: November 6, 2006

By: /s/ KEVIN M. PHILLIPS  
Name: **Kevin M. Phillips**  
Title: **Chief Financial Officer**