MAXIMUS INC
Form 10-Q
August 08, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d)

of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2007

Commission File Number: 1-12997

MAXIMUS, INC.

(Exact name of registrant as specified in its charter)

Virginia	**54-1000588**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
11419 Sunset Hills Road Reston, Virginia	**20190**
(Address of principal executive offices)	(Zip Code)

(703) 251-8500

(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 x No o

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 o Accelerated filer x Non-accelerated filer o

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

As of August 1, 2007, there were 22,173,170 shares of the registrant s common stock (no par value) outstanding.

MAXIMUS, Inc.

Quarterly Report on Form 10-Q

For the Quarter Ended June 30, 2007

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements.

MAXIMUS, Inc.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)

	September 30, 2006 (Note 1)	June 30, 2007 (unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 39,545	$ 91,105
Marketable securities	117,315	123,737
Restricted cash	1,512	323
Accounts receivable billed, net of reserves of $5,830 and $27,876	153,399	120,287
Accounts receivable unbilled	47,728	40,451
Income taxes receivable	9,003	3,598
Deferred income taxes	6,844	13,932
Prepaid expenses and other current assets	8,334	6,918
Total current assets	383,680	400,351
Property and equipment, at cost	71,078	78,030
Less accumulated depreciation and amortization	(37,649)	(44,889)
Property and equipment, net	33,429	33,141
Capitalized software	57,260	59,996
Less accumulated amortization	(23,335)	(29,901)
Capitalized software, net	33,925	30,095
Deferred contract costs, net	11,165	8,368
Goodwill	86,688	86,086
Intangible assets, net	5,720	3,994
Other assets, net	3,894	2,611
Total assets	$ 558,501	$ 564,646
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 54,484	$ 50,032
Accrued compensation and benefits	24,426	27,900
Deferred revenue	54,414	44,918
Current portion of capital lease obligations	1,690	1,742
Other accrued liabilities	1,600	32,468
Total current liabilities	136,614	157,060
Capital lease obligations, less current portion	2,044	698
Deferred income taxes	14,944	11,754
Total liabilities	153,602	169,512
Shareholders equity:		
Common stock, no par value; 60,000,000 shares authorized; 21,544,964 and 22,151,770 shares issued and outstanding at September 30, 2006 and June 30, 2007, at stated amount, respectively	156,349	173,485
Accumulated other comprehensive income (loss)	(916)	1,138
Retained earnings	249,466	220,511
Total shareholders equity	404,899	395,134
Total liabilities and shareholders equity	$ 558,501	$ 564,646

See notes to unaudited condensed consolidated financial statements.

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MAXIMUS, Inc.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands, except per share data)

(Unaudited)

	Three Months Ended June 30, 2006	2007	Nine Months Ended June 30, 2006	2007
Revenue	$ 186,596	$ 196,557	$ 529,095	$ 536,772
Cost of revenue	158,945	138,126	411,366	415,188
Write-off of deferred contract costs (Note 3)	17,109		17,109	
Gross profit	10,542	58,431	100,620	121,584
Selling, general and administrative expenses	32,275	35,350	94,725	104,454
Legal and settlement expense (Note 11)	9,078	33,010	10,303	42,114
Loss from operations	(30,811)	(9,929)	(4,408)	(24,984)
Interest and other income, net	2,196	1,131	5,174	3,223
Gain (gain adjustment) on sale of business (Note 12)		(233)		451
Income (loss) before income taxes	(28,615)	(9,031)	766	(21,310)
Provision (benefit) for income taxes (Note 13)	(11,306)	5,360	299	1,114
Net income (loss)	$ (17,309)	$ (14,391)	$ 467	$ (22,424)
Earnings (loss) per share (Note 6):				
Basic	$ (0.81)	$ (0.65)	$ 0.02	$ (1.03)
Diluted	$ (0.81)	$ (0.65)	$ 0.02	$ (1.03)
Dividends per share	$ 0.10	$ 0.10	$ 0.30	$ 0.30
Weighted average shares outstanding:				
Basic	21,472	21,998	21,442	21,767
Diluted	21,472	21,998	21,851	21,767

See notes to unaudited condensed consolidated financial statements.

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MAXIMUS, Inc.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	Nine Months Ended June 30, 2006	2007
Cash flows from operating activities:		
Net income (loss)	$ 467	$ (22,424)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	6,786	7,542
Amortization	5,839	7,912
Write-off of deferred contract costs	17,109	
Deferred income taxes	(9,547)	(10,277)
Gain on sale of business		(451)
Non-cash equity-based compensation	4,570	2,208
Change in assets and liabilities, net of effects from divestiture:		
Accounts receivable - billed	(14,721)	33,111
Accounts receivable - unbilled	(1,569)	6,232
Prepaid expenses and other current assets	(1,312)	1,428
Deferred contract costs	(13,411)	2,797
Other assets	(961)	3,261
Accounts payable	27,281	(3,959)
Accrued compensation and benefits	(1,782)	3,474
Deferred revenue	12,455	(9,091)
Income taxes	(13,816)	5,405
Other liabilities	(1,114)	32,179
Net cash provided by operating activities	16,274	59,347
Cash flows from investing activities:		
Proceeds from sale of business, net of transaction costs		1,871
Purchases of property and equipment	(8,200)	(7,390)
Capitalized software costs	(6,472)	(2,949)
Increase in marketable securities	(18,575)	(6,422)
Net cash used in investing activities	(33,247)	(14,890)
Cash flows from financing activities:		
Employee stock transactions	7,268	11,807
Repurchases of common stock	(10,139)	
Payments on capital lease obligations	(1,121)	(1,294)
Tax benefit due to option exercises and restricted stock units vesting	1,058	3,121
Cash dividends paid	(6,434)	(6,531)
Net cash (used in) provided by financing activities	(9,368)	7,103
Net increase (decrease) in cash and cash equivalents	(26,341)	51,560
Cash and cash equivalents, beginning of period	59,073	39,545
Cash and cash equivalents, end of period	$ 32,732	$ 91,105

See notes to unaudited condensed consolidated financial statements.

MAXIMUS, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

For the Three Months and Nine Months Ended June 30, 2007, and 2006

In these Notes to Unaudited Condensed Consolidated Financial Statements, the terms the Company, MAXIMUS, we, and our refer to MAXIMUS, Inc. and its subsidiaries.

1. Organization and Basis of Presentation

General

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. The results of operations for the three months and nine months ended June 30, 2007, are not necessarily indicative of the results that may be expected for the full fiscal year. The balance sheet at September 30, 2006, has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In addition to the Company s wholly owned subsidiaries, the financial statements as of and for the three months and nine months ended June 30, 2007, and 2006, include a majority (55%) owned international subsidiary in Israel.

These financial statements should be read in conjunction with the audited financial statements and the notes thereto at September 30, 2006 and 2005 and for each of the three years in the period ended September 30, 2006, included in the Company s Annual Report on Form 10-K for the year ended September 30, 2006 (File No. 1-12997) filed with the Securities and Exchange Commission on December 13, 2006.

Legal and Settlement Expense

Legal and settlement expense consists of costs, net of reimbursed insurance claims, related to significant legal settlements and non-routine legal matters, including future probable legal costs estimated to be incurred in connection with those matters. Legal expenses incurred in the ordinary course of business are included in selling, general and administrative expense.

Stock-Based Compensation

The Company s Board of Directors established stock option plans during 1997 pursuant to which the Company may grant non-qualified stock options to officers, employees and directors of the Company. Such plans also provide for stock awards and direct purchases of the Company s common stock. At June 30, 2007, the Board of Directors had reserved 8.1 million shares of common stock for issuance under the Company s stock plans. At June 30, 2007, 1.9 million shares remained available for grants under the Company s stock plans.

Stock options are granted at exercise prices equal to the fair market value of the Company s common stock at the date of grant. Stock options generally vest ratably over a period of four years and, beginning in fiscal 2005, expire six years after date of grant. Options issued prior to fiscal 2005 expire ten years after date of grant. For the three and nine months ended June 30, 2007, compensation expense recognized related to stock options was $0.1 million and $1.0 million, respectively, compared to $1.0 million and $3.3 million for the same periods in fiscal 2006.

The Company also issues Restricted Stock Units (RSUs) to certain executive officers and employees under its 1997 Equity Incentive Plan. Generally, these RSUs vest ratably over six years with full vesting upon the sixth anniversary of the date of grant, provided, however, that the vesting will accelerate if the Company meets certain earnings targets determined by the Board of Directors. The fair value of the RSUs, based on the Company s stock price at the grant date, is expensed over the vesting period. For the three and nine months ended June 30, 2007, compensation expense recognized related to RSUs was $0.7 million and $1.2 million, respectively, compared to $0.8 million and $1.3 million for the same periods in fiscal 2006.

2. Comprehensive Income (Loss)

Comprehensive income (loss) includes net income (loss), plus changes in the net unrealized gains (losses) on investments, net of taxes, and changes in cumulative foreign currency translation adjustments. The components of comprehensive income (loss) for the three months and nine months ended June 30, 2006, and 2007, are as follows:

	Three months Ended June 30,		Nine months Ended June 30,	
(dollars in thousands)	**2006**	**2007**	**2006**	**2007**
Net income (loss)	$ (17,309)	$ (14,391)	$ 467	$ (22,424)
Foreign currency translation adjustments	(476)	610	(842)	2,054
Unrealized investment gains (losses)			(7)	
Reclassification adjustment for gains/losses realized in net income, net of tax			(143)	
Comprehensive income (loss)	$ (17,785)	$ (13,781)	$ (525)	$ (20,370)

3. Deferred Contract Costs

Deferred contract costs consist of contractually recoverable direct set-up costs relating to long-term service contracts in progress. These costs include direct and incremental costs incurred prior to the commencement of the Company providing contracted services to our customers. These costs totaled $26.3 million and $27.5 million at September 30, 2006 and June 30, 2007, respectively, of which $7.6 million consisted of leased equipment. Deferred contract costs are expensed ratably as services are provided under the contracts. Accumulated amortization of deferred contract costs was $15.1 million and $19.1 million at September 30, 2006 and June 30, 2007, respectively.

During the quarter ended June 30, 2006, the Company determined that the estimated undiscounted cash flows associated with the Texas Integrated Eligibility project over its remaining term were insufficient to recover the project s deferred contract costs. As a result, the Company recognized a non-cash impairment charge of $17.1 million to write off the project s deferred contract costs. The write-off is included in the results of the Operations segment.

4. Goodwill and Intangible Assets

The changes in the carrying amount of goodwill, by each of the Company s business segments, for the nine months ended June 30, 2007 are as follows (dollars in thousands):

	Consulting	**Systems**	**Operations**	**Total**
Balance as of September 30, 2006	$ 10,902	$ 42,154	$ 33,632	$ 86,688
Goodwill activity during period			(602)	(602)
Balance as of June 30, 2007	$ 10,902	$ 42,154	$ 33,030	$ 86,086

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During the quarter ended December 31, 2006, the Company sold its Corrections Services business and allocated $0.7 million of goodwill to the sale transaction. During the quarter ended June 30, 2007, the Company reduced the goodwill allocated to the sale of the Corrections Services business by $0.1 million to reflect the impact of a post-closing balance sheet adjustment to the sale price that was contemplated as part of the arrangement.

The following table sets forth the components of intangible assets (dollars in thousands):

	As of September 30, 2006			As of June 30, 2007		
	Cost	**Accumulated amortization**	**Intangible assets, net**	**Cost**	**Accumulated amortization**	**Intangible assets, net**
Non-competition agreements	$ 3,475	$ 3,288	$ 187	$ 3,275	$ 3,231	$ 44
Technology-based intangibles	4,870	2,532	2,338	4,870	3,199	1,671
Customer contracts and relationships	7,475	4,280	3,195	6,475	4,196	2,279
Total	$ 15,820	$ 10,100	$ 5,720	$ 14,620	$ 10,626	$ 3,994

Intangible assets from acquisitions are amortized over five to ten years. The weighted-average amortization period for intangible assets is approximately six years. Intangible amortization expense was $0.4 million and $1.3 million for the three months and nine months ended June 30, 2007, respectively. The estimated amortization expense for the years ending September 30, 2007, 2008, 2009, 2010, 2011 and 2012 is $1.7 million, $1.5 million, $1.1 million, $0.4 million, $0.4 million, and $0.2 million, respectively. During the three months ended December 31, 2006, the Company disposed of $0.4 million of intangible assets (net of accumulated amortization of $0.8 million) related to the sale of its Corrections Services business.

5. Commitments and Contingencies

Litigation

The Company is involved in various legal proceedings, including contract and employment claims, in the ordinary course of its business. The matters reported on below involve significant pending or potential claims against us.

(a) In October 2004, MAXIMUS received a subpoena from the Criminal Division of the U.S. Department of Justice (DOJ) acting through the U.S. Attorney s Office for the District of Columbia (USAO). The subpoena requested records pertaining to the Company s work for the District of Columbia, primarily relating to the preparation and submission of federal Medicaid reimbursement claims on behalf of the District. The government alleged that the Company knowingly submitted Medicaid claims on behalf of the District of Columbia that lacked sufficient supporting documentation.

In July 2007, MAXIMUS agreed to settle this matter with the DOJ, the USAO and the United States Department of Health and Human Services (HHS). As part of the settlement, the Company entered into: (i) a Settlement Agreement with the DOJ on behalf of the Office of Inspector General of HHS (the DOJ Settlement Agreement); (ii) a Corporate Integrity Agreement with HHS (the Integrity Agreement); and (iii) a Deferred Prosecution Agreement with the USAO (the Deferred Prosecution Agreement).

Pursuant to the terms of the DOJ Settlement Agreement, the Company paid the United States Government $30.5 million. In addition, the Company paid $460 thousand to settle employment and attorney s fees claims of a former employee who filed a False Claims Act lawsuit relating to this matter.

Under the Integrity Agreement, the Company is required to revise and enhance its existing compliance program, including the appointment of a compliance officer and compliance committee, the development of written standards including a code of conduct and policies and procedures, the provision of relevant training and education to its employees and the creation of a disclosure program. The Company is required to engage the HHS Office of Audit Services to review its implementation of the Company s obligations under the Integrity Agreement and will be subject to certain notification and reporting requirements. The Integrity Agreement requires the Company to assume certain compliance obligations for a period of five years.

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Pursuant to the terms and conditions of the Deferred Prosecution Agreement, the USAO agreed to defer the filing of criminal charges against the Company for 24 months, provided that the Company accepts responsibility for its conduct, cooperates with the USAO, makes the settlement payment and complies with Federal criminal laws. If the Company satisfies its obligations under the Deferred Prosecution Agreement for the 24-month deferral period, the USAO has agreed not to file criminal charges against the Company with respect to this matter.

Based on the probable legal costs of the Company s internal review of the matter, we recorded a charge of $0.5 million in the quarter ended December 31, 2005 and an additional charge of $0.3 million in the quarter ended March 31, 2007. Based on the DOJ Settlement Agreement described above, we recorded an additional charge of $31.7 million in the quarter ended June 30, 2007 consisting of $30.5 million paid to the United States, $460 thousand paid to the former employee and the remainder for associated legal fees.

(b) In June 2005, MAXIMUS received a subpoena pursuant to the Illinois Whistleblower Reward and Protection Act from the Office of the Attorney General of Illinois in connection with a purported whistleblower investigation of potential false claims. The subpoena requested records pertaining to the Company s work for agencies of the Executive Branch of Illinois State Government. Discussions with the Attorney General s office indicated that MAXIMUS was one of nine contractors that received such subpoenas and that the investigation was focused on the procurement and contracting activities of the Illinois Department of Central Management Services. MAXIMUS fully responded to the subpoena by December 2005, and there has been no activity involving the Company since that time. MAXIMUS was recently informed that it is neither a target nor a subject of the investigation. For these reasons, and in consultation with legal counsel, the Company believes this matter is not material. This matter will not be reported on further unless there are significant new developments.

(c) In December 2006, Emergis, Inc. filed a demand for arbitration against MAXIMUS and certain of its wholly-owned subsidiary companies in British Columbia, Canada. Emergis was a subcontractor to MAXIMUS BC Health, Inc. and MAXIMUS BC Health Benefit Operations, Inc. in support of their contract with the British Columbia Ministry of Health. The subcontract required Emergis to provide a system for the adjudication, processing and payment of health care claims for the Province and had a total value of approximately $32.0 million Canadian ($30.1 million U.S. as of June 30, 2007). Because Emergis failed to meet product development and delivery requirements under the subcontract, MAXIMUS declared Emergis in default and ultimately terminated the subcontract in September 2006. In its demand for arbitration, Emergis challenges the basis of the termination, alleges that the subcontract remains in force and seeks payment of damages including the amounts that it would have received under the subcontract. MAXIMUS believes that termination was justified and that, in any event, damages would be limited to the contractual limitation of liability, which is less than $2.0 million Canadian ($1.9 million U.S. as of June 30, 2007). The parties are currently engaged in the discovery process. The arbitration hearing is scheduled for February 2008.

(d) In January 2007, MAXIMUS delivered to Accenture LLP a written formal demand for arbitration to resolve disputes relating to the Company s role as a subcontractor in support of Accenture s prime contract with the Texas Health and Human Services Commission (HHSC) for the Integrated Eligibility and Enrollment Services program (the Program). The Company s claims include (i) Accenture s attempt to misappropriate the Company s intellectual property, (ii) Accenture s failure to deliver required technology under the subcontract, (iii) Accenture s unilateral negotiation of issues with HHSC having a direct effect on the Company, (iv) Accenture s unfounded assertions that the Company had breached its obligations with respect to the Children s Health Insurance Program (CHIP) operations under the subcontract, and (v) Accenture s imposition of excessive and unsubstantiated cover costs on the Company arising out of the amendment to the subcontract entered into in June 2006. MAXIMUS seeks to recover its damages which it believes exceed $100.0 million. Accenture submitted a response disputing MAXIMUS claims and asserting a counterclaim that MAXIMUS breached the subcontract. Accenture seeks unspecified damages which it has stated could be hundreds of millions of dollars. The subcontract incorporated the terms and conditions of the prime contract which contains a limitation of liability of $250.0 million.

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Also in January 2007, Accenture delivered a letter purporting to declare the Company in default of its obligations under that subcontract. The letter stated that Accenture planned to exercise step-in rights with respect to certain management and supervisory services provided by the Company for the CHIP operations. The letter also stated that Accenture intended to partially terminate the subcontract as of February 5, 2007 with respect to the Company s obligations regarding CHIP integrated eligibility services. The letter included a proposed turnover plan for transitioning the CHIP services from the Company to Accenture. Accenture has alleged that the Company owes damages relating to the CHIP operations of at least $45.0 million plus $30.0 million in indemnification for amounts that Accenture agreed to pay to HHSC.

In February 2007, MAXIMUS terminated its subcontract with Accenture. In March 2007, HHSC announced that it was winding down its contract with Accenture. In connection with that process, MAXIMUS has entered into interim agreements directly with HHSC to provide enrollment broker, CHIP systems, CHIP operations and eligibility support services. MAXIMUS is also negotiating a longer-term agreement with HHSC to run the enrollment broker program through 2010.

The Company believes that its positions are meritorious and that Accenture s positions are without merit, including Accenture s unjustified issuance of a default notice with respect to the CHIP operations. During the nine months ended June 30, 2007, the Company recorded $7.8 million in legal costs related to the arbitration. This amount represents costs incurred to date of $4.8 million and an estimate of future probable legal costs of $3.0 million. The Company will continue to aggressively pursue its rights and remedies against Accenture to resolve the current dispute. The arbitration hearing is scheduled for the third quarter of fiscal year 2008. The Company cannot predict the outcome of the arbitration proceedings or any settlement negotiations or the impact they may have on the Company s operating results or financial condition.

Credit Facilities and Performance Bonds

In June 2003, in connection with a long-term contract, the Company issued a standby letter of credit in an initial amount of up to $20.0 million, which amount was reduced to $10.0 million on April 1, 2005. The letter of credit, which expires on March 31, 2009, may be called by the customer in the event the Company defaults under the terms of the contract. In March 2006, in connection with another long-term contract, the Company issued a standby letter of credit in the amount of $4.0 million. The letter of credit, which expires on September 30, 2008, may be called by the customer in the event the Company defaults under the terms of the contract. Both letters of credit contain financial covenants that establish minimum levels of tangible net worth, earnings before interest, tax, depreciation and amortization (EBITDA), cash balances and a maximum level of losses on the Texas Integrated Eligibility project. The Company was in compliance with all covenants as of June 30, 2007.

At June 30, 2007, the Company had performance bond commitments totaling $120.0 million.

Lease Obligations

On July 15, 2003, the Company entered into a capital lease financing arrangement with a financial institution, whereby the Company acquired assets pursuant to an equipment lease agreement. Rental payments for assets leased are payable over a 60-month period at an interest rate of 4.05% commencing in January 2004. On March 29, 2004, the Company entered into a supplemental capital lease financing arrangement with the same financial institution whereby the Company acquired additional assets pursuant to an equipment lease agreement. Rental payments for assets leased under the supplemental arrangement are payable over a 57-month period at an interest rate of 3.61% commencing in April 2004. Capital lease obligations of $3.7 million and $2.4 million were outstanding related to these lease arrangements for new equipment at September 30, 2006 and June 30, 2007, respectively.

6. Earnings (Loss) Per Share

The following table sets forth the components of basic and diluted earnings (loss) per share (dollars in thousands):

	Three Months Ended June 30, 2006	2007	Nine Months Ended June 30, 2006	2007
Numerator:				
Net income (loss)	$ (17,309)	$ (14,391)	$ 467	$ (22,424)
Denominator:				
Basic weighted average shares outstanding	21,472	21,998	21,442	21,767
Effect of dilutive securities:				
Employee stock options and unvested restricted stock units			409	
Denominator for diluted earnings (loss) per share	21,472	21,998	21,851	21,767

In computing diluted loss per share for the three months and nine months ended June 30, 2007, employee stock options and unvested restricted stock units aggregating 352,000 and 277,000, respectively, were excluded from the computation of diluted loss per share as a result of their antidilutive effect. In computing diluted loss per share for the three months ended June 30, 2006, employee stock options and unvested restricted stock units aggregating 297,000 were excluded from the computation of diluted loss per share as a result of their antidilutive effect.

7. Stock Repurchase Program

Under resolutions adopted in May 2000, July 2002, and March 2003, the Board of Directors authorized the repurchase, at management s discretion, of up to an aggregate of $90.0 million of the Company s common stock. In addition, in June 2002, the Board of Directors authorized the use of option exercise proceeds for the repurchase of the Company s common stock. During the three months and nine months ended June 30, 2007, the Company did not repurchase any shares. At June 30, 2007, $38.8 million remained authorized for future stock repurchases under the program. On July 23, 2007, the Company announced that it has retained UBS Investment Bank as a financial advisor to assist the Board of Directors in exploring strategic alternatives to enhance shareholder value, including a possible sale of the Company. As long as the process of evaluating strategic alternatives is underway, we do not intend to resume the repurchase of shares under the Company s stock repurchase program.

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8. Segment Information

The following table provides certain financial information for each of the Company s business segments.

(dollars in thousands)	Three Months Ended June 30, 2006	2007	Nine Months Ended June 30, 2006	2007
Revenue:				
Consulting	$ 26,714	$ 23,285	$ 76,717	$ 71,165
Systems	28,686	33,957	97,205	103,910
Operations	131,196	139,315	355,173	361,697
Total	$ 186,596	$ 196,557	$ 529,095	$ 536,772
Income (loss) from operations:				
Consulting	$ 3,818	$ 2,020	$ 9,330	$ 5,867
Systems	(3,010)	(3,617)	1,155	(5,121)
Operations	(23,121)	24,570	(6,509)	15,584
Consolidating adjustments	580	108	1,919	800
Legal and settlement expense	(9,078)	(33,010)	(10,303)	(42,114)
Total	$ (30,811)	$ (9,929)	$ (4,408)	$ (24,984)

9. Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board issued Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes which is effective in fiscal years beginning after December 15, 2006, which is the Company s 2008 fiscal year. The purpose of FIN 48 is to clarify and set forth consistent rules for accounting for uncertain tax positions in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes. The cumulative effect of initially applying the provisions of this interpretation are required to be reported separately as an adjustment to the opening balance of retained earnings in the year of adoption. We are in the process of reviewing and evaluating FIN 48, and therefore the ultimate impact of its adoption is not yet known.

In February 2007, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 which is effective in fiscal years beginning after November 15, 2007, which is the Company s 2009 fiscal year. SFAS No. 159 permits entities to choose to measure eligible items at fair value at specified election dates and report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. We are in the process of reviewing and evaluating SFAS No. 159, and therefore the ultimate impact of its adoption is not yet known.

10. Subsequent Event

Effective July 6, 2007, the Company s Board of Directors declared a quarterly cash dividend of $0.10 for each share of the Company s common stock outstanding. The dividend is payable on August 31, 2007, to shareholders of record on August 15, 2007. Based on the current number of shares outstanding, the payment will be $2.2 million.

11. Legal and Settlement Expense

Legal and settlement expense consists of costs, net of reimbursed insurance claims, related to significant legal settlements and non-routine legal matters, including future probable legal costs estimated to be incurred in connection with those matters. Legal expenses incurred in the ordinary course of business are included in selling, general and administrative expense. The following table sets forth the matters that represent legal and settlement expense:

	Three months ended June 30,		Nine months ended June 30,	
(dollars in thousands)	2006	2007	2006	2007
District of Columbia Contract Investigation and Related Settlement	$	$ 31,660	$ 500	$ 31,964
Computer Equipment Leases Settlement	9,078	(150)	9,078	(150)
Texas Integrated Eligibility Project		1,500		7,800
Ontario Child Support Project Settlement				2,500
Former CEO Investigation and Related Settlement			725	
Total	$ 9,078	$ 33,010	$ 10,303	$ 42,114

See Note 5. Commitments and Contingencies above and Special Considerations and Risk Factors in Exhibit 99.1 for additional information.

12. Sale of Business

During the quarter ended December 31, 2006, the Company sold its Corrections Services business for proceeds of $2.2 million, net of transaction costs of $0.8 million, and recognized a pre-tax gain on the sale of $0.7 million. During the quarter ended June 30, 2007, the Company recorded an adjustment to this gain of $0.2 million, net of goodwill of $0.1 million, to reflect the impact of a post-closing balance sheet adjustment to the sale price that was contemplated as part of the arrangement. During the fiscal year ended September 30, 2006, this business had revenue of $9.1 million and generated an operating loss of approximately $0.6 million.

13. Income Taxes

Provision for income taxes for the three months ended June 30, 2007 was $5.4 million which consisted of (1) a $4.5 million tax benefit related to legal fees and settlement expenses of $33.0 million (portions of the settlement expenses are not tax deductible), and (2) a $9.9 million tax provision at 42.0% on income before income taxes of $24.0 million (loss before income taxes of $9.0 million for the three months ended June 30, 2007 less legal fees and settlement expenses of $33.0 million).

Provision for income taxes for the nine months ended June 30, 2007 was $1.1 million which consisted of (1) a $8.3 million tax benefit related to legal fees and settlement expenses of $42.1 million (portions of the settlement expenses are not tax deductible), (2) a $0.7 million valuation allowance on certain deferred tax assets related to a foreign subsidiary s net operating losses, and (3) a $8.7 million tax provision at 42.0% on income before income taxes of $20.8 million (loss before income taxes of $21.3 million for the nine months ended June 30, 2007 less legal fees and settlement expenses of $42.1 million).

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

The following discussion and analysis of financial condition and results of operations is provided to enhance the understanding of, and should be read in conjunction with, our Consolidated Financial Statements and related Notes included both herein and in our Annual Report on Form 10-K for the year ended September 30, 2006, filed with the Securities and Exchange Commission on December 13, 2006.

Forward Looking Statements

From time to time, we may make forward-looking statements that are not historical facts, including statements about our confidence and strategies and our expectations about revenue, results of operations, profitability, current and future contracts, market opportunities, market demand or acceptance of our products and services. Any statements contained in this Quarterly Report on Form 10-Q that are not statements of historical fact may be forward-looking statements. The words could, estimate, future, intend, may, opportunity, potential, project, anticipates, plans, expect and similar expressions are intended to identify forward-looking statements. These statements may involve risks and uncertainties that could cause our actual results to differ materially from those indicated by such forward-looking statements. These risks are detailed in Exhibit 99.1 to this Quarterly Report on Form 10-Q and incorporated herein by reference.

Business Overview

We are a leading provider of consulting, systems solutions and operations program management primarily to government. Since our inception, we have been at the forefront of innovation in meeting our mission of Helping Government Serve the People®. We use our expertise, experience and advanced information technology to make government operations more efficient while improving the quality of services provided to program beneficiaries. We operate primarily in the United States, and we have had contracts with government agencies in all 50 states, Canada, Australia, Israel, and the United Kingdom. For the fiscal year ended September 30, 2006, we had revenue of $700.9 million and net income of $2.5 million. For the nine months ended June 30, 2007, we had revenue of $536.8 million and net loss of $22.4 million.

Results of Operations

Consolidated

The following table sets forth, for the periods indicated, selected statements of income data:

	Three months ended June 30,		Nine months ended June 30,	
(dollars in thousands, except per share data)	**2006**	**2007**	**2006**	**2007**
Revenue	$ 186,596	$ 196,557	$ 529,095	$ 536,772
Write-off of deferred contract costs	$ 17,109		$ 17,109	
Gross profit	$ 10,542	$ 58,431	$ 100,620	$ 121,584
Legal and settlement expense	$ 9,078	$ 33,010	$ 10,303	$ 42,114
(Loss) from operations	$ (30,811)	$ (9,929)	$ (4,408)	$ (24,984)
Operating (loss) percentage	(16.5)%	(5.1)%	(0.8)%	(4.7)%
Selling, general and administrative expense	$ 32,275	$ 35,350	$ 94,725	$ 104,454
Selling, general and administrative expense as a percentage of revenue	17.3			