# 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, 2004**

**Commission file number 1-12997**

# MAXIMUS, INC.
(Exact name of registrant as specified in its charter)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes☒ No ☐

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practical date.

| Class | Outstanding at August 3, 2004 |
|---|---|
| Common stock, no par value | 21,692,818 |

**MAXIMUS, Inc.**

**Quarterly Report on Form 10-Q**
**For the Quarter Ended June 30, 2004**

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Signature

Exhibit Index

*Throughout this Quarterly Report on Form 10-Q, the terms "we," "us," "our" and "MAXIMUS" refer to MAXIMUS, Inc. and its subsidiaries.*

**MAXIMUS, Inc.**
**CONDENSED CONSOLIDATED BALANCE SHEETS**
**(Dollars in thousands)**

| | September 30, 2003 (Note 1) | June 30, 2004 (unaudited) |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 117,372 | $ 131,611 |
| Restricted cash | 3,653 | 1,601 |
| Marketable securities | 140 | — |
| Accounts receivable – billed, net | 114,992 | 122,659 |
| Accounts receivable – unbilled | 29,142 | 40,522 |
| Deferred income taxes | 3,410 | 413 |
| Prepaid expenses and other current assets | 7,063 | 8,893 |
| Total current assets | 275,772 | 305,699 |
| Property and equipment, at cost | 46,412 | 51,446 |
| Less accumulated depreciation and amortization | (20,195) | (25,398) |
| Property and equipment, net | 26,217 | 26,048 |
| Capitalized software | 23,382 | 29,142 |
| Less accumulated amortization | (8,699) | (11,528) |
| Capitalized software, net | 14,683 | 17,614 |
| Deferred contract costs, net | 7,283 | 16,367 |
| Goodwill | 81,757 | 84,710 |
| Intangible assets, net | 7,212 | 10,289 |
| Other assets, net | 2,096 | 6,057 |
| Total assets | $ 415,020 | $ 466,784 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 21,578 | $ 25,778 |
| Accrued compensation and benefits | 23,219 | 21,514 |
| Deferred revenue | 22,356 | 25,341 |
| Income taxes payable | 2,837 | 1,866 |
| Current portion of capital lease obligations | 809 | 1,631 |
| Other accrued liabilities | 3,653 | 1,663 |
| Total current liabilities | 74,452 | 77,793 |
| Capital lease obligations, less current portion | 3,821 | 5,527 |
| Deferred income taxes | 2,745 | 10,899 |
| Other liabilities | 725 | 137 |
| Total liabilities | 81,743 | 94,356 |
| Shareholders' equity: | | |
| Common stock, no par value; 60,000,000 shares authorized; 21,200,197 and 21,650,875 shares issued and outstanding at September 30, 2003 and June 30, 2004, at stated amount, respectively | 146,219 | 156,839 |
| Accumulated other comprehensive loss | (95) | (150) |
| Retained earnings | 187,153 | 215,739 |
| Total shareholders' equity | 333,277 | 372,428 |
| Total liabilities and shareholders' equity | $ 415,020 | $ 466,784 |

*See notes to unaudited condensed consolidated financial statements.*



**MAXIMUS, Inc.**
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**
**(In thousands, except per share data)**
**(Unaudited)**

| | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|---|---|---|---|---|
| | 2003 | 2004 | 2003 | 2004 |
| Revenue | $ 141,741 | $ 160,158 | $ 405,095 | $ 449,759 |
| Cost of revenue | 99,321 | 114,696 | 281,828 | 317,083 |
| Gross profit | 42,420 | 45,462 | 123,267 | 132,676 |

| | | | | |
|---|---|---|---|---|
| Selling, general and administrative expenses | 27,933 | 29,340 | 81,674 | 86,245 |
| Income from operations | 14,487 | 16,122 | 41,593 | 46,431 |
| Interest and other income, net | 331 | 291 | 1,268 | 819 |
| Income before income taxes | 14,818 | 16,413 | 42,861 | 47,250 |
| Provision for income taxes | 5,853 | 6,483 | 16,930 | 18,664 |
| Net income | $ 8,965 | $ 9,930 | $ 25,931 | $ 28,586 |
| Earnings per share: | | | | |
| Basic | $ 0.43 | $ 0.46 | $ 1.23 | $ 1.32 |
| Diluted | $ 0.43 | $ 0.45 | $ 1.22 | $ 1.29 |
| Weighted average shares outstanding: | | | | |
| Basic | 20,731 | 21,664 | 21,016 | 21,612 |
| Diluted | 21,015 | 22,071 | 21,285 | 22,095 |

*See notes to unaudited condensed consolidated financial statements.*



**MAXIMUS, Inc.**
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(In thousands)**
**(Unaudited)**

| | Nine Months Ended June 30, | |
|---|---|---|
| | 2003 | 2004 |
| **Cash flows from operating activities:** | | |
| Net income | $ 25,931 | $ 28,586 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 3,872 | 5,203 |
| Amortization | 3,725 | 4,366 |
| Deferred income taxes | (435) | 11,151 |
| Tax benefit due to option exercises | 523 | 3,604 |
| Non-cash equity based compensation | 726 | 809 |
| Change in assets and liabilities, net of effects from acquisitions: | | |
| Accounts receivable - billed | (11,323) | (7,667) |
| Accounts receivable - unbilled | (3,702) | (11,380) |
| Prepaid expenses and other current assets | (707) | (1,511) |
| Deferred contract costs | (1,148) | (5,758) |
| Other assets | 262 | (4,360) |
| Accounts payable | 8,785 | 4,168 |
| Accrued compensation and benefits | 100 | (1,705) |
| Deferred revenue | 8,795 | 2,195 |
| Income taxes payable | 169 | (971) |
| Other liabilities | (1,545) | (526) |
| Net cash provided by operating activities | 34,028 | 26,204 |
| **Cash flows from investing activities:** | | |
| Acquisition of businesses, net of cash acquired | (13,532) | (6,429) |
| Purchases of property and equipment | (4,574) | (4,961) |
| Capitalized software costs | (2,954) | (6,212) |
| Other | (1,611) | 227 |
| Net cash used in investing activities | (22,671) | (17,375) |
| **Cash flows from financing activities:** | | |
| Employee stock transactions | 3,682 | 21,340 |
| Repurchases of common stock | (20,394) | (15,133) |
| Payments on capital lease obligations | (109) | (797) |
| Net cash (used in) provided by financing activities | (16,821) | 5,410 |
| Net (decrease) increase in cash and cash equivalents | (5,464) | 14,239 |
| Cash and cash equivalents, beginning of period | 94,965 | 117,372 |

| | | |
|---|---|---|
| Cash and cash equivalents, end of period | $ 89,501 | $ 131,611 |

*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, 2004 and 2003**

*In these Notes to Unaudited Condensed Consolidated Financial Statements, the terms the "Company" and "MAXIMUS" 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, 2004 are not necessarily indicative of the results that may be expected for the full fiscal year. The balance sheet at September 30, 2003 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.

These financial statements should be read in conjunction with the audited financial statements as of September 30, 2003 and 2002 and for each of the three years in the period ended September 30, 2003, included in the Company's Annual Report on Form 10-K for the year ended September 30, 2003 (File No. 1-12997) filed with the Securities and Exchange Commission on December 19, 2003.

*Stock-Based Compensation*

The Company accounts for its employee stock option plan under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*("APB 25"), and related Interpretations. No stock option based employee compensation cost is reflected in net income, as all employee stock options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of grant.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value provisions of Financial Accounting Standard No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosure*("FAS 148"), to stock-based employee compensation for the periods indicated.



| | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|---|---|---|---|---|
| | 2003 | 2004 | 2003 | 2004 |
| | (in thousands, except per share data) | | | |
| Net income, as reported | $ 8,965 | $ 9,930 | $ 25,931 | $ 28,586 |
| Deduct: Stock compensation expense determined under fair value based method, net of taxes | (1,501 ) | (1,245 ) | (5,108 ) | (3,876 ) |
| Net income, as adjusted | $ 7,464 | $ 8,685 | $ 20,823 | $ 24,710 |
| Earnings per share: | | | | |
| Basic – as reported | $ 0.43 | $ 0.46 | $ 1.23 | $ 1.32 |
| Basic – as adjusted | $ 0.36 | $ 0.40 | $ 0.99 | $ 1.14 |
| Diluted – as reported | $ 0.43 | $ 0.45 | $ 1.22 | $ 1.29 |
| Diluted – as adjusted | $ 0.36 | $ 0.39 | $ 0.98 | $ 1.12 |

**2. Deferred Contract Costs**

Deferred contract costs consist of reimbursable direct project costs relating to the transition phase of a long-term contract in progress, which are required to be reimbursed under the terms of the contract. These costs, net of related amortization, include system development and facility build-out costs totaling $7.3 million and $16.4 million at September 30, 2003 and June 30, 2004, respectively, of which $4.2 million and $7.6 million is leased equipment at September 30, 2003 and June 30, 2004, respectively. Deferred contract costs are amortized over five years as services are provided under the contract, beginning January 2004. Amortization of deferred contract costs was $1.1 million and $1.8 million for the three months and nine months ended June 30, 2004, respectively.

**3. Business Combinations**

In fiscal 2004, the Company acquired the businesses described below in business combinations accounted for as purchases. Accordingly, the accompanying unaudited condensed consolidated financial statements include the results of operations of the acquired businesses since the dates of their respective acquisition.

On May 3, 2004, the Company acquired substantially all the assets of TIECorp for $3.2 million. In conjunction with the purchase, the Company recorded intangible assets, primarily non-competition agreements and technology related intangibles, of $3.4 million, which have been assigned to the Human Services business segment. Per the terms of the acquisition agreement, additional consideration of up to $16.5 million may be paid based on achievement of certain future performance objectives by TIECorp. The TIECorp business is engaged in the development and marketing of instructional management software programs and related products and services in the educational field. The primary reason for the acquisition was to expand the Company's presence in the educational software field and to strategically complement the Company's current product and service offerings in the educational market.

On June 1, 2004, the Company acquired certain assets of Manatron, Inc. for $1.8 million. In conjunction with the purchase, the Company recorded goodwill of $1.5 million and intangible assets, primarily customer contracts and relationships, of $0.8 million, which have been assigned to the Technical Services business segment. The acquired assets relate to the design, development, marketing and support of judicial software products for county, city and township governments. The primary reason for the acquisition was to increase the Company's market share in the justice solutions arena.

**4. Goodwill and Intangible Assets**

The changes in the carrying amount of goodwill for the nine months ended June 30, 2004 are as follows (in thousands):



| | Health Services | Human Services | Technical Services | Total |
|---|---|---|---|---|
| Balance as of September 30, 2003 | $ 1,792 | $ 37,288 | $ 42,677 | $ 81,757 |
| Acquisition of Manatron, Inc. | — | — | 1,517 | 1,517 |
| Other additions during period | — | 1,106 | 330 | 1,436 |
| Balance as of June 30, 2004 | $ 1,792 | $ 38,394 | $ 44,524 | $ 84,710 |

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

| | As of September 30, 2003 | | | As of June 30, 2004 | | |
|---|---|---|---|---|---|---|
| | Cost | Accumulated Amortization | Intangible Assets, net | Cost | Accumulated Amortization | Intangible Assets, net |
| Non-competition agreements | $ 3,425 | $ 2,854 | $ 571 | $ 3,475 | $ 2,958 | $ 517 |
| Technology-based intangibles | 1,500 | 264 | 1,236 | 4,837 | 533 | 4,304 |
| Customer contracts and relationships | 6,700 | 1,295 | 5,405 | 7,475 | 2,007 | 5,468 |
| Total | $ 11,625 | $ 4,413 | $ 7,212 | $ 15,787 | $ 5,498 | $ 10,289 |

Intangible assets from acquisitions are amortized over five to ten years. The weighted-average amortization period for intangible assets is approximately seven years. Intangible amortization expense was approximately $0.4 million and $1.1 million for the three and nine months ended June 30, 2004, respectively. The estimated amortization expense for the years ending September 30, 2004, 2005, 2006, 2007 and 2008 is $1.6 million, $2.0 million, $2.0 million, $2.0 million and $1.6 million, respectively.

**5. Commitments and Contingencies**

*Litigation*

On January 3, 2003, the City of San Diego served the Company with a complaint naming DMG-MAXIMUS (DMG – previously a wholly-owned subsidiary of MAXIMUS since merged into MAXIMUS) as a defendant in an on-going lawsuit between the City and Conwell Shonkwiler & Associates, an architectural firm (CSA). In 2002, both CSA and the City had sued each other for claims arising out of design services provided by CSA for the City's Water Department Central Facility Water Project (Project). DMG had provided certain assessment and preliminary design services to the City in connection with the Project. CSA sued the City for payment of approximately $0.7 million in unpaid fees, and the City sued CSA for alleged damages caused by CSA's breach of the contract and professional negligence in rendering those services. In its defense, CSA asserted that any deficiencies in its services were due to errors in the master program document prepared for the City by DMG. Consequently, the City named DMG as a defendant in the lawsuit alleging breach of contract and professional negligence and seeking indemnity from DMG. The City alleged damages against all defendants of at least $10.0 million. All parties have tentatively agreed to settle this matter. The MAXIMUS share of the settlement is not material and will be covered by insurance.

On December 8, 2003, David M. Johnson, a former officer of the Company, sued MAXIMUS, David V. Mastran, and Lynn P. Davenport in the federal District Court for the Northern District of Ohio in connection with the termination of his employment in August 2003. The matter has since been transferred to the federal District Court for the Eastern District of Virginia. In October 2002, Mr. Johnson signed a four-year employment agreement with the Company. His complaint asserts that his employment was wrongfully terminated by the defendants, and alleges breach of contract, promissory estoppel, fraud, interference with contract, and intentional infliction of emotional distress. Mr. Johnson claims damages of at least $11.0 million. MAXIMUS believes that Mr. Johnson's claims are without merit and intends to defend the action vigorously. Although there can be no assurance of a favorable outcome, the Company does not believe that this action will have a material adverse effect on its financial condition or results of operations, and the Company has not accrued for any loss related to this action.



In the third quarter of fiscal 2004, the Company learned that two former employees who were principals in a small business MAXIMUS acquired in 2000 had signed fraudulent guarantees on behalf of MAXIMUS for computer equipment leases apparently used in a competitive enterprise completely unrelated to MAXIMUS business. The Company never had any knowledge of the leases or guarantees. On July 14, 2004, the Company filed suit against those individuals. Solarcom LLC, the leasing company, has demanded $31.0 million from MAXIMUS under the guarantees, which amount represents the remaining payments under the leases. On August 6, 2004, De Lage Landen Financial Services, Inc. sued MAXIMUS and Solarcom in the federal District Court for the Eastern District of Pennsylvania in connection with this matter. Solarcom had sold and assigned certain of the lease payments to De Lage Landen. De Lage Landen has sued MAXIMUS to enforce the guarantees, and has claimed damages of at least $10.0 million. The Company believes that amount is part of the $31.0 million demanded by Solarcom. Because the guarantees were fraudulently signed, and because the leasing company did not perform appropriate due diligence, the Company believes that it is not liable under the guarantees and will vigorously contest any claim for payment. The Company has also reported the matter to law enforcement authorities. Although there can be no assurance of a favorable outcome, the Company does not believe that this action will have a material adverse effect on its financial condition or results of operations, and the Company has not accrued for any loss related to this action.

The Company is involved in various other legal proceedings, including contract claims, in the ordinary course of its business. Management does not expect the ultimate outcome of any of these legal proceedings to have a material adverse effect on the Company's financial condition or its results of operations.

*Financial Instruments – Letter of Credit*

On June 18, 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 shall be 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. The facility contains financial covenants that establish minimum levels of tangible net worth and earnings before interest, tax, depreciation and amortization (EBITDA) and require the maintenance of certain cash balances. The Company was in compliance with all covenants at June 30, 2004.

*Lease Obligations*

On July 15, 2003, the Company entered into a capital lease financing arrangement with a financial institution, whereby the Company may acquire assets pursuant to an equipment lease agreement. Rental payments for assets leased are payable over a 60-month period at a 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 may acquire 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 a rate of 3.61% commencing in April 2004. At June 30, 2004, capital lease obligations of approximately $7.6 million were outstanding related to these lease arrangements for new equipment. Capital leases entered into during the nine months ended June 30, 2004 were approximately $3.3 million.

### 6. Earnings Per Share

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

| | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|---|---|---|---|---|
| | 2003 | 2004 | 2003 | 2004 |
| Numerator: | | | | |
| Net income | $ 8,965 | $ 9,930 | $ 25,931 | $ 28,586 |
| Denominator: | | | | |
| Basic weighted average shares outstanding | 20,731 | 21,664 | 21,016 | 21,612 |
| | | | | |
| Effect of dilutive securities: | | | | |
| Employee stock options and unvested restricted stock awards | 284 | 407 | 269 | 483 |
| Denominator for diluted earnings per share | 21,015 | 22,071 | 21,285 | 22,095 |

### 7. Stock Repurchase Program

Under resolutions adopted in May 2000, July 2002, and March 2003, the Board of Directors has 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 nine months ended June 30, 2004, the Company repurchased approximately 439,000 shares. At June 30, 2004, $42.2 million remained authorized for future stock repurchases under the program.

### 8. Stock Option Plans

In May 2002, the Company issued 170,000 Restricted Stock Units (RSUs) to certain executive officers and employees under its 1997 Equity Incentive Plan. The grant-date fair value of each RSU was $30.14. The RSUs vest annually 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 as set forth in the RSUs. The fair value of the RSUs at the grant date is amortized to expense over the vesting period. Compensation expense recognized related to these RSUs was approximately $0.7 million and $0.6 million for the nine months ended June 30, 2003 and 2004, respectively.

In March 2004, the Company issued 96,800 RSUs to certain executive officers and employees under its 1997 Equity Incentive Plan. The grant-date fair value of each RSU was $34.90. The RSUs vest annually 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 as set forth in the RSUs. The fair value of the RSUs at the grant date is amortized to expense over the vesting period. Compensation expense recognized related to these RSUs was approximately $0.2 million for the nine months ended June 30, 2004.

For the nine months ended June 30, 2004, approximately 815,000 stock options were exercised under the Company's stock option plan and approximately 25,000 RSU's were vested and released.

### 9. Segment Information

Effective April 1, 2004, we implemented certain internal organizational changes to better manage our business. As a result, we now report each of our three Strategic Business Units as separate external reporting segments.



The following table provides certain financial information for each of the Company's business segments. The earlier periods are reflective of the change in the composition of our reportable segments as if we had operated under the new organizational structure during those periods.

| | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|---|---|---|---|---|
| (in thousands) | 2003 | 2004 | 2003 | 2004 |
| Revenue: | | | | |
| Health Services | $ 40,923 | $ 59,193 | $ 123,032 | $ 149,505 |
| Human Services | 60,363 | 60,043 | 172,543 | 182,829 |
| Technical Services | 40,455 | 40,922 | 109,520 | 117,425 |
| Total | $ 141,741 | $ 160,158 | $ 405,095 | $ 449,759 |
| | | | | |
| Gross Profit: | | | | |
| Health Services | $ 8,532 | $ 12,628 | $ 28,474 | $ 33,908 |
| Human Services | 17,851 | 17,346 | 47,027 | 53,727 |
| Technical Services | 16,037 | 15,488 | 47,766 | 45,041 |
| Total | $ 42,420 | $ 45,462 | $ 123,267 | $ 132,676 |
| | | | | |
| Income from Operations: | | | | |
| Health Services | $ 4,034 | $ 7,612 | $ 15,326 | $ 19,822 |
| Human Services | 6,925 | 4,266 | 15,641 | 15,953 |
| Technical Services | 3,218 | 3,707 | 9,602 | 9,526 |
| Consolidating adjustments | 310 | 537 | 1,024 | 1,130 |
| Total | $ 14,487 | $ 16,122 | $ 41,593 | $ 46,431 |



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

**Business Overview**

We are a leading provider of health and human services program management, consulting services and systems solutions primarily to government agencies. 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. We have been profitable every year since we were founded in 1975. For the fiscal year ended September 30, 2003, we had revenue of $558.3 million and net income of $35.3 million. For the nine months ended June 30, 2004, we had revenue of $449.8 million and net income of $28.6 million.

Effective April 1, 2004, we implemented certain internal organizational changes to better manage our business. As a result, we now report each of our three Strategic Business Units (i.e., Health Services, Human Services, and Technical Services) as separate external reporting segments. The financial segment information provided below is reflective of this change in the composition of our reportable segments as if we had operated under the new organizational structure during prior periods.

**Business Combinations**

In fiscal 2004, we acquired the businesses described below in business combinations accounted for as purchases.

On May 3, 2004, we acquired substantially all the assets of TIECorp for $3.2 million. In conjunction with the purchase, we recorded intangible assets, primarily non-competition agreements and technology related intangibles, of $3.4 million, which have been assigned to the Human Services business segment. Per the terms of the acquisition agreement, additional consideration of up to $16.5 million may be paid based on achievement of certain future performance objectives by TIECorp. The TIECorp business is engaged in the development and marketing of instructional management software programs and related products and services in the educational field. The primary reason for the acquisition was to expand our presence in the educational software field and to strategically complement our current product and service offerings in the educational market.

On June 1, 2004, we acquired certain assets of Manatron, Inc. for $1.8 million. In conjunction with the purchase, we recorded goodwill of $1.5 million and intangible assets, primarily customer contracts and relationships, of $0.8 million, which have been assigned to the Technical Services business segment. The acquired assets relate to the design, development, marketing and support of judicial software products for county, city and township governments. The primary reason for the acquisition was to increase our market share in the justice solutions arena.



**Results of Operations**

*Consolidated*

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

| | Three Months Ended June 30, 2003 | Three Months Ended June 30, 2004 | Nine Months Ended June 30, 2003 | Nine Months Ended June 30, 2004 |
|---|---|---|---|---|
| | (dollars in thousands, except per share data) | | | |
| Revenue | $ 141,741 | $ 160,158 | $ 405,095 | $ 449,759 |
| Cost of revenue | 99,321 | 114,696 | 281,828 | 317,083 |
| Gross profit | $ 42,420 | $ 45,462 | $ 123,267 | $ 132,676 |
| Gross margin percentage | 29.9% | 28.4% | 30.4% | 29.5% |
| Selling, general and administrative | $ 27,935 | $ 29,340 | $ 81,674 | $ 86,245 |
| Selling, general and administrative percentage | 19.7% | 18.3% | 20.2% | 19.2% |
| Net income | $ 8,965 | $ 9,930 | $ 25,931 | $ 28,586 |
| Earnings per share: | | | | |
| Basic | $ 0.43 | $ 0.46 | $ 1.23 | $ 1.32 |
| Diluted | $ 0.43 | $ 0.45 | $ 1.22 | $ 1.29 |

Our revenue increased 13.0% for the three months ended June 30, 2004 compared to the same period in fiscal 2003. Excluding revenue of $3.5 million related primarily to an acquisition in May 2003, our revenue for the three months ended June 30, 2004 increased 12.3% when compared to the three months ended June 30, 2003. For the nine months ended June 30, 2004 compared to the same period in fiscal 2003, our revenue increased 11.0%. Excluding revenue of $9.9 million related primarily to an acquisition in May 2003, our revenue for the nine months ended June 30, 2004 increased 9.2% when compared to the nine months ended June 30, 2003.

Our gross margin decreased to 28.4% for the three months ended June 30, 2004, a decrease of 1.5%, compared to 29.9% for the same period in the 2003 fiscal year. For the nine months ended June 30, 2004, our gross margin decreased to 29.5%, a decrease of 0.9%, compared to 30.4% for the same period in the 2003 fiscal year.

Selling, general and administrative expense (SG&A) consists of management, marketing and administration costs (including salaries, benefits, bid and proposal efforts, travel, recruiting, continuing education, employee training and non-chargeable labor costs), facilities costs, printing, reproduction, communications, equipment depreciation, intangible amortization and non-cash equity based compensation. SG&A increased in the three months and nine months ended June 30, 2004 compared to the same periods in fiscal 2003 due to the increase in expenses necessary to support higher revenue and to strengthen the infrastructure to market our products and grow our business, including our proposal facilities and systems, and new finance, operational, and compliance personnel. Our SG&A as a percentage of revenue decreased to 18.3% for the three months ended June 30, 2004 compared to 19.7% for the same period in the 2003 fiscal year. For the nine months ended June 30, 2004, our SG&A as a percentage of revenue decreased to 19.2% compared to 20.2% for the same period in the 2003 fiscal year.

Also included in SG&A is approximately $0.4 million and $0.8 million of non-cash equity-based compensation expense for the three months and nine months ended June 30, 2004, respectively, and approximately $0.2 million and $0.7 million for the three months and nine months ended June 30, 2003, respectively, related to the issuance of restricted stock units in May 2002 and March 2004. In future quarters, the quarterly amortization expense related to these restricted stock units is estimated to be approximately $0.4 million, which amount may increase if certain earnings targets are achieved.



Our provision for income taxes for both the three month and nine months ended June 30, 2004 and 2003 was 39.5% of income before income taxes.

Net income for the three months ended June 30, 2004 was $9.9 million, or $0.45 per diluted share, compared with net income of $9.0 million, or $0.43 per diluted share, for the three months ended June 30, 2003. Net income for the nine months ended June 30, 2004 was $28.6 million, or $1.29 per diluted share, compared with net income of $25.9 million, or $1.22 per diluted share, for the nine months ended June 30, 2003. The increase in net income is attributed primarily due to the contributions of our Health Services segment and Technical Services segment as discussed in more detail below.

*Health Services*

| | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|---|---|---|---|---|
| | 2003 | 2004 | 2003 | 2004 |
| | (dollars in thousands) | | | |
| Revenue | $ 40,923 | $ 59,193 | $ 123,032 | $ 149,505 |
| Cost of revenue | 32,391 | 46,565 | 94,558 | 115,597 |
| Gross profit | $ 8,532 | $ 12,628 | $ 28,474 | $ 33,908 |
| Gross margin percentage | 20.8% | 21.3% | 23.1% | 22.7% |

Revenue of our Health Services segment increased 44.6% for the three months ended June 30, 2004 compared to the same period in fiscal 2003, and increased 21.5% for the nine months ended June 30, 2004 compared to the same period in fiscal 2003. These increases were due primarily to the contribution of revenue from the California Healthy Families project which commenced operations on January 1, 2004. Gross margin increased to 21.3% for the three months ended June 30, 2004 from 20.8% for the same period in fiscal 2003 as a result of improved profitability on certain projects. Gross margin decreased to 22.7% for the nine months ended June 30, 2004 from 23.1% for the same period in fiscal 2003.

*Human Services*

| | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|---|---|---|---|---|
| | 2003 | 2004 | 2003 | 2004 |
| | (dollars in thousands) | | | |
| Revenue | $ 60,363 | $ 60,043 | $ 172,543 | $ 182,829 |
| Cost of revenue | 42,512 | 42,697 | 125,516 | 129,102 |
| Gross profit | $ 17,851 | $ 17,346 | $ 47,027 | $ 53,727 |
| Gross margin percentage | 29.6% | 28.9% | 27.3% | 29.4% |

Revenue of our Human Services segment was relatively flat for the three months ended June 30, 2004 compared to the same period in fiscal 2003, and increased 6.0% for the nine months ended June 30, 2004 compared to the same period in fiscal 2003. Included in revenue for the nine months ended June 30, 2004, was revenue related to the Correctional Services business acquired on May 1, 2003, which was approximately $9.6 million compared to $2.3 million of revenue related to this acquisition for the nine months ended June 30, 2003. Also included in the third quarter of fiscal 2004 was a charge of approximately $1.1 million for certain accounts receivables that may be at risk stemming from an investigation of fraudulent activities by two terminated employees with whom we are now in litigation. Gross margin decreased to 28.9% for the three months ended June 30, 2004 from 29.6% for the same period in fiscal 2003 due primarily to the above mentioned $1.1 million charge. Gross margin increased to 29.4% for the nine months ended June 30, 2004 from 27.3% for the same period in fiscal 2003 as a result of improved profitability on certain projects in the segment.



*Technical Services*

| | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|---|---|---|---|---|
| | 2003 | 2004 | 2003 | 2004 |
| | (dollars in thousands) | | | |
| Revenue | $ 40,455 | $ 40,922 | $ 109,520 | $ 117,425 |
| Cost of revenue | 24,418 | 25,434 | 61,754 | 72,384 |
| Gross profit | $ 16,037 | $ 15,488 | $ 47,766 | $ 45,041 |
| Gross margin percentage | 39.6% | 37.8% | 43.6% | 38.4% |

Revenue of our Technical Services segment increased 1.2% for the three months ended June 30, 2004 compared to the same period in fiscal 2003, and increased 7.2% for the nine months ended June 30, 2004 compared to the same period in fiscal 2003. These increases were primarily due to revenue from new contracts. Gross margin decreased to 37.8% for the three months ended June 30, 2004 from 39.6% for the same period in fiscal 2003, and to 38.4% for the nine months ended June 30, 2004 from 43.6% for the same period in fiscal 2003. These decreases in gross margin were primarily due to less software license revenue, which carries higher gross margins.

**Other Income**

| | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|---|---|---|---|---|
| | 2003 | 2004 | 2003 | 2004 |
| | (dollars in thousands) | | | |
| Interest and other income, net | $ 331 | $ 291 | $ 1,268 | $ 819 |
| Percentage of revenue | 0.2% | 0.2% | 0.3% | 0.2% |

Interest and other income decreased during the three months and nine months ended June 30, 2004 when compared to the same periods in the previous fiscal year due primarily to lower interest rates on our invested cash and cash equivalents and our incurring of interest expense on our capital lease obligations beginning in January 2004.

**Liquidity and Capital Resources**

| Nine Months Ended June, | |
|---|---|
| 2003 | 2004 |

| | (dollars in thousands) | |
|---|---|---|
| Net cash provided by (used in): | | |
| Operating activities | $ 34,028 | $ 26,204 |
| Investing activities | (22,671) | (17,375) |
| Financing activities | (16,821) | 5,410 |
| Net (decrease) increase in cash and cash equivalents | $ (5,464) | $ 14,239 |

For the nine months ended June 30, 2004, cash provided by our operations was $26.2 million, compared to $34.0 million for the nine months ended June 30, 2003. Cash provided by operating activities for the nine months ended June 30, 2004 primarily consisted of net income of $28.6 million plus non-cash items aggregating $25.1 million offset by net uses of working capital of $27.5 million. Non-cash items included $9.6 million of depreciation and amortization, $3.6 million from the income tax benefit of option exercises and $11.1 million from deferred income taxes. The net uses of working capital reflect increases in accounts receivable-billed of $7.7 million and accounts receivable-unbilled of $11.4 million, increases in deferred contract costs of $5.8 million, and increases in other assets, primarily longer term accounts receivable, of $4.4 million, net of increases in accounts payable of $4.2



million. The increase in accounts receivable-billed and unbilled during the nine months ended June 30, 2004 was primarily due to certain milestone based billings in our Technical Services segment and billings related to our California Healthy Families contract in our Health Services segment. During the nine months ended June 30, 2003, cash provided by operating activities consisted primarily of net income of $25.9 million plus non-cash items of $8.4 million and net decreases in working capital of $0.3 million. Non-cash items included $7.6 million of depreciation and amortization. The net increases in working capital were primarily due to increases in accounts receivable-billed and unbilled totaling $15.0 million offset by increases in deferred revenue of $8.8 million and accounts payable of $8.8 million.

For the nine months ended June 30, 2004, cash used in investing activities was $17.4 million, compared to $22.7 million for the nine months ended June 30, 2003. Cash used in investing activities for the nine months ended June 30, 2004 primarily consisted of acquisitions of businesses of $6.4 million, expenditures for capitalized software costs of $6.2 million (which includes approximately $2.7 million of purchased software during the three month period ended June 30, 2004) and purchases of property and equipment of $5.0 million. During the nine months ended June 30, 2003, we used $13.5 million related to the acquisition of businesses, $3.0 million for expenditures related to capitalized software costs, and $4.6 million for purchases of property and equipment.

For the nine months ended June 30, 2004, cash provided by financing activities was $5.4 million, compared to cash used of $16.8 million for the nine months ended June 30, 2003. Cash provided by financing activities for the nine months ended June 30, 2004 primarily consisted of $21.3 million of employee stock transactions offset by $15.1 million of common stock repurchases. Cash used in financing activities for the nine months ended June 30, 2003 primarily consisted of $3.7 million of employee stock transactions offset by $20.4 million of common stock repurchases.

Under resolutions adopted in May 2000, July 2002, and March 2003, the Board of Directors has 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 nine months ended June 30, 2004, the Company repurchased approximately 439,000 shares. At June 30, 2004, $42.2 million remained authorized for future stock repurchases under the program.

Our working capital at June 30, 2004 was $227.9 million and we had cash and cash equivalents of $131.6 million and no debt, except for capital lease obligations. Management believes this strong liquidity and financial position will allow us to continue our stock repurchase program, depending on the price of the Company's common stock, and to pursue selective acquisitions. Restricted cash represents amounts collected on behalf of certain customers and its use is restricted for liabilities specified under our contracts with these customers.

Under the provisions of a recently awarded long-term contract, we incurred certain reimbursable transition period costs. During this transition period, these expenditures resulted in the use of our cash and in our entering into lease financing arrangements for a portion of the costs. Reimbursement of these costs will occur over the 60 months of the contract operating period, which commenced in January 2004. As of June 30, 2004, approximately $16.4 million in costs, net of amortization of approximately $1.8 million, had been incurred and reported as deferred contract costs on our June 30, 2004 condensed consolidated balance sheet. Also under the provisions of this contract, we issued a standby letter of credit in an initial amount of up to $20.0 million, which amount shall be 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 we default under the terms of the contract. The facility contains financial covenants that establish minimum levels of tangible net worth and earnings before interest, tax, depreciation and amortization (EBITDA) and require the maintenance of certain cash balances. We were in compliance with the covenants at June 30, 2004.

In July 2003, we entered into a capital lease financing arrangement with a financial institution, whereby we may acquire assets pursuant to an equipment lease agreement. Rental payments for assets leased will be payable over a 60-month period at a rate of 4.05% commencing in January 2004. In March 2004, we entered into a supplemental



capital lease financing arrangement with the same financial institution whereby we may acquire 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 a rate of 3.61% commencing in April 2004. At June 30, 2004, capital lease obligations of approximately $7.6 million were outstanding related to these lease arrangements for new equipment. Capital leases entered into during the nine months ended June 30, 2004 were approximately $3.3 million.

At June 30, 2004, we classified accounts receivable of approximately $4.4 million, net of a $1.1 million discount, as long-term receivables and reported them within the other assets category on our June 30, 2004 condensed consolidated balance sheet. These receivables have extended payment terms and collection is expected to exceed one-year.

We believe that we will have sufficient resources to meet our currently anticipated capital expenditure andworking capital requirements for at least the next twelve months.

**Critical Accounting Policies and Estimates**

Our discussion and analysis of financial condition and results of operations is 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 financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent liabilities and the reported amounts of revenue and expenses. On an ongoing basis, we evaluate our estimates including those related to revenue recognition and cost estimation on certain contracts, the realizability of goodwill, and amounts related to income taxes, certain accrued liabilities and contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results could differ from those estimates.

We believe that we do not have material off-balance sheet risk or exposure to liabilities that are not recorded or disclosed in our financial statements. While we have significant operating lease commitments for office space, those commitments are generally tied to the period of performance under related contracts. Additionally, although on certain contracts we are bound by performance bond commitments and standby letters of credit, we have not had any defaults resulting in draws on performance bonds or letters of credit. Also, we do not enter into derivative transactions.

We believe the following critical accounting policies affect the significant judgments and estimates used in the preparation of our consolidated financial statements:

*Revenue recognition*. In fiscal 2003, approximately 82% of our total revenue was derived from state and local government agencies; 6% from federal government agencies; and 12% from other sources, such as foreign and commercial customers. Our revenue is generated from contracts with various payment arrangements, including: (1) fixed-price; (2) costs incurred plus a negotiated fee ("cost-plus"); (3) performance-based criteria; and (4) time and materials. Also, some contracts contain "not-to-exceed" provisions. For fiscal 2003, revenue from fixed-price contracts was approximately 36% of total revenue; revenue from cost-plus contracts was approximately 17% of total revenue; revenue from performance-based contracts was approximately 33% of total revenue; and revenue from time and materials contracts was approximately 14% of total revenue. A majority of our contracts with state and local government agencies have been fixed-price and performance-based and our contracts with the federal government have been cost-plus. Fixed-price and performance-based contracts generally offer higher margins but typically involve more risk than cost-plus or time and materials reimbursement contracts.

We recognize revenue on fixed-priced contracts when earned, as services are provided. For certain fixed price contracts, we recognize revenue based on costs incurred using estimates of total expected contract revenue and costs to be incurred. The cumulative impact of any revisions in estimated revenue and costs are recognized in the period in which the facts that give rise to the revision become known. Also, with fixed-price contracts, we are



subject to the risk of potential cost overruns. Provisions for estimated losses on incomplete contracts are provided in full in the period in which such losses become known. We recognize revenue on our performance-based contracts as such revenue becomes fixed or determinable, which generally occurs when amounts are billable to customers. For certain contracts, this may result in revenue being recognized in large, irregular increments. Additionally, costs related to certain contracts are incurred in periods prior to recognizing revenue and are generally expensed. Certain of these direct costs may be deferred until services are provided and revenue begins to be recognized when reimbursement of such costs is contractually guaranteed. These factors may result in irregular revenue and profit margins mainly for performance-based contracts which exist in our Health Services segment and Human Services segment. With performance-based contracts we have more uncertainty regarding expected future revenue.

Our most significant expense is cost of revenue, which consists primarily of project-related costs such as employee salaries and benefits, subcontractors, computer equipment and travel expenses. Our management uses its judgment and experience to estimate cost of revenue expected on projects. Our management's ability to accurately predict personnel requirements, salaries and other costs as well as to effectively manage a project or achieve certain levels of performance can have a significant impact on the gross margins related to our fixed-price, performance-based and time and materials contracts. If actual costs are higher than our management's estimates, profitability may be adversely affected. Service cost variability has little impact on cost-plus arrangements because allowable costs are reimbursed by the customer.

We also license software under non-cancelable license agreements. License fee revenue is recognized when a non-cancelable license agreement is in force, the product has been shipped, the license fee is fixed or determinable, and collection is probable. If the fee is not fixed or determinable, revenue is recognized as payments become due from the customer. In addition, when software license contracts contain post-contract customer support as part of a multiple element arrangement, revenue is recognized based upon the vendor-specific objective evidence of the fair value of each element. Maintenance and post-contract customer support revenue are recognized ratably over the term of the related agreements, which in most cases is one year. Revenue from software-related consulting services under time and material contracts and for training is recognized as services are performed. Revenue from other software-related contract services requiring significant modification or customization of software is recognized under the percentage-of-completion method.

Beginning July 1, 2003, EITF 00-21, *Revenue Arrangements with Multiple Deliverables*, requires contracts with multiple deliverables to be divided into separate units of accounting if certain criteria are met. While EITF 00-21 has not had a material impact on our financial statements, we apply the guidance therein and recognize revenue on multiple deliverables as separate units of accounting if the criteria are met.

Health Services segment and Human Services segment contracts generally contain base periods of one or more years as well as one or more option periods that may cover more than half of the potential contract duration. As of our most recently ended fiscal year, our average Human Services segment and Health Services segment contract duration was approximately two years. Our average Technical Services segment contract duration was one year.

*Impairment of goodwill*. In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, *Business Combinations* ("FAS 141"), and No. 142, *Goodwill and Other Intangible Assets* ("FAS 142"). Under the new rules, goodwill is no longer amortized but is subject to annual impairment tests in accordance with FAS 141 and FAS 142. We elected to adopt FAS 141 and 142 effective October 1, 2001, and as a result, amortization of goodwill was discontinued as of October 1, 2001. Upon adoption, the required impairment tests were performed. These impairment tests did not result in any impairment loss. Goodwill is tested on an annual basis in our fourth quarter, or more frequently as impairment indicators arise. Annual impairment tests involve the use of estimates related to the fair market values of our reporting units with which goodwill is associated. Losses, if any, resulting from annual impairment tests will be reflected in operating income in our income statement.



*Capitalized Software Development Costs*. Capitalized software development costs are capitalized in accordance with FAS No. 86, *Accounting for the Cost of Computer Software to be Sold, Leased, or Otherwise Marketed*. We capitalize both purchased software that is ready for resale and costs incurred internally for software development projects from the time technological feasibility is established. Capitalized software development costs are reported at the lower of unamortized cost or estimated net realizable value. Upon the general release of the software to customers, capitalized software development costs for the products are amortized over the greater of the ratio of gross revenues to expected total revenues of the product or the straight-line method of amortization over the estimated economic life of the product, which ranges from three to five years. The establishment of technological feasibility and the ongoing assessment for recoverability of capitalized development costs require considerable judgment by management including, but not limited to, technological feasibility, anticipated future gross revenues, estimated economic life, and changes in software and hardware technologies. Any changes to these estimates could impact the amount of amortization expense and the amount recognized as capitalized software development costs in the consolidated balance sheet.

**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," "will," "believes," "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. Examples of these risks include reliance on government clients; risks associated with government contracting; risks involved in managing government projects; legislative changes and political developments; opposition from government unions; challenges resulting from growth; adverse publicity; and legal, economic, and other risks detailed in Exhibit 99.1 to this Quarterly Report on Form 10-Q.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

We believe that our exposure to market risk related to the effect of changes in interest rates, foreign currency exchange rates, commodity prices and equity prices with regard to instruments entered into for trading or for other purposes is immaterial.

**Item 4. Controls and Procedures.**

(a) Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our principal executive officer and principal financial officer concluded that these disclosure controls and procedures are effective and designed to ensure that the information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the requisite time periods.

(b) Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) identified in connection with the evaluation of our internal control that occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



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**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings.**

On January 3, 2003, the City of San Diego served us with a complaint naming DMG-MAXIMUS (DMG – previously a wholly-owned subsidiary of MAXIMUS since merged into MAXIMUS) as a defendant in an on-going lawsuit between the City and Conwell Shonkwiler & Associates, an architectural firm (CSA). In 2002, both CSA and the City had sued each other for claims arising out of design services provided by CSA for the City's Water Department Central Facility Water Project (Project). DMG had provided certain assessment and preliminary design services to the City in connection with the Project. CSA sued the City for payment of approximately $0.7 million in unpaid fees, and the City sued CSA for alleged damages caused by CSA's breach of the contract and professional negligence in rendering those services. In its defense, CSA asserted that any deficiencies in its services were due to errors in the master program document prepared for the City by DMG. Consequently, the City named DMG as a defendant in the lawsuit alleging breach of contract and professional negligence and seeking indemnity from DMG. The City alleged damages against all defendants of at least $10.0 million. All parties have tentatively agreed to settle this matter. Our share of the settlement is not material and will be covered by insurance.

On December 8, 2003, David M. Johnson, a former officer of MAXIMUS, sued us, David V. Mastran, and Lynn P. Davenport in the federal District Court for the Northern District of Ohio in connection with the termination of his employment in August 2003. The matter has since been transferred to the federal District Court for the Eastern District of Virginia. In October 2002, Mr. Johnson signed a four-year employment agreement with us. His complaint asserts that his employment was wrongfully terminated by the defendants, and alleges breach of contract, promissory estoppel, fraud, interference with contract, and intentional infliction of emotional distress. Mr. Johnson claims damages of at least $11.0 million. We believe that Mr. Johnson's claims are without merit and we intend to defend the action vigorously. Although there can be no assurance of a favorable outcome, we do not believe that this action will have a material adverse effect on our financial condition or results of operations, and we have not accrued for any loss related to this action.

In the third quarter of fiscal 2004, we learned that two former employees who were principals in a small business we acquired in 2000 had signed fraudulent guarantees on behalf of MAXIMUS for computer equipment leases apparently used in a competitive enterprise completely unrelated to our business. We never had any knowledge of the leases or guarantees. On July 14, 2004, we filed suit against those individuals. Solarcom LLC, the leasing company, has demanded $31.0 million from us under the guarantees, which amount represents the remaining payments under the leases. On August 6, 2004, De Lage Landen Financial Services, Inc. sued MAXIMUS and Solarcom in the federal District Court for the Eastern District of Pennsylvania in connection with this matter. Solarcom had sold and assigned certain of the lease payments to De Lage Landen. De Lage Landen has sued MAXIMUS to enforce the guarantees, and has claimed damages of at least $10.0 million. We believe that amount is part of the $31.0 million demanded by Solarcom. Because the guarantees were fraudulently signed, and because the leasing company did not perform appropriate due diligence, we believe that we are not liable under the guarantees and will vigorously contest any claim for payment. We have also reported the matter to law enforcement authorities. Although there can be no assurance of a favorable outcome, we do not believe that this action will have a material adverse effect on our financial condition or results of operations, and we have not accrued for any loss related to this action.

We are involved in various other legal proceedings, including contract claims, in the ordinary course of its business. We do not expect the ultimate outcome of any of these legal proceedings to have a material adverse effect on our financial condition or our results of operations.



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**Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities.**

The following table sets forth the information required regarding repurchases of common stock that we made during the three months ended June 30, 2004:

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans (1) | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plan (in thousands) |
|---|---|---|---|---|
| April 1, 2004 – April 30, 2004 | — | — | — | $ 44,325 |
| May 1, 2004 – May 30, 2004 | 57,300 | $ 34.79 | 57,300 | $ 42,446 |
| June. 1, 2004 – June 30, 2004 | 45,100 | $ 34.91 | 45,100 | $ 42,244 |
| Total | 102,400 | $ 34.84 | 102,400 | |

(1) Under resolutions adopted and publicly announced on May 12, 2000, July 10, 2002, and April 2, 2003, our Board of Directors has authorized the repurchase, at management's discretion, of up to an aggregate of $90.0 million of common stock under our 1997 Equity Incentive Plan. In addition, in June 2002, the Board of Directors authorized the use of option exercise proceeds for the repurchase of our common stock.

**Item 6. Exhibits and Reports on Form 8-K.**

(a) Exhibits. The Exhibits filed as part of this Quarterly Report on Form 10-Q are listed on the Exhibit Index immediately preceding the Exhibits. The Exhibit Index is incorporated herein by reference.

(b) Reports on Form 8-K.

During the quarter ended June 30, 2004, we filed or furnished the following Current Reports on Form 8-K:

1) Current Report on Form 8-K (Item 12) was furnished on May 6, 2004 to announce our financial results for the three months and six months ended March 31, 2004.
2) Current Report on Form 8-K (Item 5) was filed on June 30, 2004 to disclose segment financial information reflecting recent organizational changes.



**SIGNATURE**

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.

MAXIMUS, INC.

Date: August 12, 2004

By: /s/ Richard A. Montoni
Richard A. Montoni
Chief Financial Officer
(On behalf of the registrant and as Principal
Financial and Accounting Officer)



EXHIBIT INDEX

| Exhibit No. | Description |
|---|---|
| 31.1 | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Section 906 Principal Executive Officer Certification. |
| 32.2 | Section 906 Principal Financial Officer Certification. |
| 99.1 | Important Factors Regarding Forward Looking Statements. |

**EXHIBIT 31.1**

**Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, David V. Mastran, certify that:

1. I have reviewed this quarterly report on Form 10-Q of MAXIMUS, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   c) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Dated: August 12, 2004

/s/ David V. Mastran
David V. Mastran
Chief Executive Officer

**EXHIBIT 31.2**

**Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Richard A. Montoni, certify that:

1. I have reviewed this quarterly report on Form 10-Q of MAXIMUS, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   c) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Dated: August 12, 2004

/s/ Richard A. Montoni
Richard A. Montoni
Chief Financial Officer

**EXHIBIT 32.1**

**Section 906 CEO Certification**

I, David V. Mastran, Chief Executive Officer of MAXIMUS, Inc. (“the Company”), do hereby certify, under the standards set forth in and solely for the purposes of 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Quarterly Report on Form 10-Q of the Company for the period ended June 30, 2004 (the “Quarterly Report”) fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) and

2. The information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 12, 2004

/s/ David V. Mastran
David V. Mastran
Chief Executive Officer

**EXHIBIT 32.2**

**Section 906 CFO Certification**

I, Richard A. Montoni, Chief Financial Officer of MAXIMUS, Inc. ("the Company"), do hereby certify, under the standards set forth in and solely for the purposes of 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Quarterly Report on Form 10-Q of the Company for the period ended June 30, 2004 (the "Quarterly Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) and

2. The information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 12, 2004

/s/ Richard A. Montoni
Richard A. Montoni
Chief Financial Officer

**EXHIBIT 99.1**

**Important Factors Regarding Forward Looking Statements**

From time to time, we may make forward-looking public statements, such as statements concerning our then-expected future revenue or earnings or concerning projected plans, performance or contract procurement, as well as other estimates relating to future operations. Forward-looking statements may be in reports filed under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), in press releases or in informal statements made with the approval of an authorized executive officer. The words or phrases “will likely result,” “are expected to,” “will continue,” “is anticipated,” “estimate,” “project,” “believe,” “could,” “intend,” “may,” “opportunity,” “plan,” “potential” or similar terms and expressions are intended to identify “forward-looking statements” within the meaning of Section 21E of the Exchange Act and Section 27A of the Securities Act of 1933, as amended, as enacted by the Private Securities Litigation Reform Act of 1995.

We wish to caution you not to place undue reliance on these forward-looking statements that speak only as of the date on which they are made. In addition, we wish to advise you that the factors listed below, as well as other factors we have not currently identified, could affect our financial or other performance and could cause our actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods or events in any current statement.

We will not undertake and we specifically decline any obligation to publicly release revisions to these forward-looking statements to reflect either circumstance after the date of the statements or the occurrence of events that may cause us to re-evaluate our forward-looking statements.

In connection with the “safe harbor” provisions of the Private Securities Litigation Reform Act, we are hereby filing the following cautionary statements identifying important factors that could cause our actual results to differ materially from those projected in forward-looking statements made by us or on our behalf:

**If we fail to satisfy our contractual obligations or meet performance standards, our contracts may be terminated and we may incur significant costs or liabilities, including penalties, which could adversely impact our operating results, financial condition and our ability to compete for future contracts.**

Our contracts may be terminated for our failure to satisfy our contractual obligations or to meet performance standards and often require us to indemnify customers. In addition, some of our contracts contain substantial liquidated damages provisions and financial penalties related to performance failures. Although we have liability insurance, the policy coverage and limits may not be adequate to provide protection against all potential liabilities. Further, for certain contracts, we have posted significant performance bonds or issued letters of credit to secure our indemnification and other obligations. If a claim is made against a performance bond or letter of credit, we would be required to reimburse the issuer for the amount of the claim. Consequently, as a result of the above matters, our contracts may be terminated and we may incur significant costs or liabilities, including penalties, which could adversely impact our operating results, financial condition and our ability to compete for future contracts.

**If we fail to accurately estimate the factors upon which we base our contract pricing, we may generate less profit than expected or incur losses on those contracts.**

We derived approximately 36% of our fiscal 2003 revenue from fixed-price contracts and approximately 33% of our fiscal 2003 revenue from performance-based contracts. For fixed-price contracts, we receive our fee based on services provided. Those services might include operating a Medicaid enrollment center pursuant to specified standards, designing and implementing computer systems or applications, or delivering a planning document under a consulting arrangement. For performance-based contracts, we receive our fee on a per-

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transaction basis. These contracts include, for example, child support enforcement contracts, in which we often receive a fee based on the amount of child support collected. To earn a profit on these contracts, we must accurately estimate costs involved and assess the probability of completing individual transactions, within the contracted time period. If our estimates prove to be inaccurate, we may not achieve the level of profit we expected or we may incur a net loss on a contract.

**If we are unable to manage our growth, our profitability will be adversely affected.**

Sustaining our growth places significant demands on our management as well as on our administrative, operational and financial resources. For us to continue to manage our growth, we must continue to improve our operational, financial and management information systems and expand, motivate and manage our workforce. If our growth comes at the expense of providing quality service and generating reasonable profits, our ability to successfully bid for contracts and our profitability will be adversely affected.

**Government entities have in the past and may in the future terminate their contracts with us earlier than we expect, which may result in revenue shortfalls.**

Many of our government contracts contain base periods of one or more years, as well as option periods covering more than half of the contract’s potential duration. Government agencies do not have to exercise these option periods, and they may elect not to exercise them for budgetary, performance, or any other reason. The profitability of some of our contracts could be adversely impacted if the option periods are not exercised. Our contracts also typically contain provisions permitting a government customer to terminate the contract on short notice, with or without cause. The unexpected termination of significant contracts could result in significant revenue shortfalls. If revenue shortfalls occur and are not offset by corresponding reductions in expenses, our business could be adversely affected. We cannot anticipate if, when or to what extent a customer might terminate its contracts with us.

**Government unions may oppose outsourcing of government programs to outside vendors such as us, which could limit our market opportunities.**

Our success depends in part on our ability to win profitable contracts to administer and manage health and human services programs traditionally administered by government employees. Many government employees, however, belong to labor unions with considerable financial resources and lobbying networks. Unions have in the past applied, and are likely to continue to apply, political pressure on legislators and other officials seeking to outsource government programs. For example, union lobbying was instrumental in influencing the Department of Health and Human Services to deny a petition to allow private corporations to make Food Stamp and Medicaid eligibility determinations in Texas. Union opposition may result in fewer opportunities for us to service government agencies.

**We may lose executive officers and senior managers on whom we rely to generate business and execute projects successfully.**

The ability of our executive officers and our senior managers to generate business and execute projects successfully is important to our success. While we have employment agreements with some of our executive officers, those agreements do not prevent them from terminating their employment with us. The loss of an executive officer or senior manager could impair our ability to secure and manage engagements.

**We may be precluded from bidding and performing certain work due to other work we currently perform.**

Various laws and regulations prohibit companies from performing work for government agencies that might be viewed as an actual or apparent conflict of interest. These laws may limit our ability to pursue and perform certain types of work. For example, some of our Financial Services divisions assist government agencies in developing requests for proposals (RFPs) for various government programs. In those situations, the divisions

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involved in operating such programs would likely be precluded from bidding on those RFPs.

**Government agencies may investigate and audit our contracts and, if any improprieties are found, we may be required to refund revenue we have received, or forego anticipated revenue, and may be subject to penalties and sanctions, including prohibitions on our bidding in response to RFPs.**

The government agencies we contract with have the authority to audit and investigate our contracts with them. As part of that process, the government agency reviews our performance on the contract, our pricing practices, our cost structure and our compliance with applicable laws, regulations and standards. If the agency determines that we have improperly allocated costs to a specific contract, we will not be reimbursed for those costs and we will be required to refund the amount of any such costs that have been reimbursed. If a government audit uncovers improper or illegal activities by us or we otherwise determine that these activities have occurred, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeitures of profits, suspension of payments, fines and suspension or disqualification from doing business with the government. Any adverse determination could adversely impact our ability to bid in response to RFPs in one or more jurisdictions.

**We may incur significant costs before receiving related contract payments that could result in increasing the use of cash and accounts receivable.**

When we are awarded a contract, we may incur significant expenses before we receive contract payments, if any. These expenses may include leasing office space, purchasing office equipment and hiring personnel. In other situations, contract terms provide for billing upon achievement of specified project milestones. As a result, in these situations, we are required to expend significant sums of money before receiving related contract payments. In addition, payments due to us from government agencies may be delayed due to billing cycles or as a result of failures to approve governmental budgets in a timely manner. These factors could impact us by increasing the use of cash and accounts receivable. Moreover, these impacts could be exacerbated if we fail to either invoice the government agency or collect our fee in a timely manner.

**Inaccurate, misleading or negative media coverage could adversely affect our reputation and our ability to bid for government contracts.**

Because of the public nature of many of our business lines, the media frequently focuses its attention on our contracts with government agencies. If the media coverage is negative, it could influence government officials to slow the pace of outsourcing government services, which could reduce the number of RFPs. The media also focuses its attention on the activities of political consultants engaged by us and we may be tainted by adverse media coverage about their activities, even when those activities are unrelated to our business. Moreover, inaccurate, misleading or negative media coverage about us could harm our reputation and, accordingly, our ability to bid for and win government contracts.

**We obtain most of our business through responses to government RFPs. We may not be awarded contracts through this process in the future and contracts we are awarded may not be profitable.**

Substantially all of our customers are government authorities. To market our services to government customers, we are often required to respond to government RFPs which may result in contract awards on a competitive basis. To do so effectively, we must estimate accurately our cost structure for servicing a proposed contract, the time required to establish operations and likely terms of the proposals submitted by competitors. We must also assemble and submit a large volume of information within an RFP's rigid timetable. Our ability to respond successfully to RFPs will greatly impact our business. We may not be awarded contracts through the RFP process and our proposals may not result in profitable contracts.

**We may be unable to attract and retain sufficient qualified personnel to sustain our business.**

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Our delivery of services is labor-intensive. When we are awarded a government contract, we must quickly hire project leaders and case management personnel. The additional staff also creates a concurrent demand for increased administrative personnel. Our success requires that we attract, develop, motivate and retain:

- experienced and innovative executive officers;
- senior managers who have successfully managed or designed government services programs; and
- information technology professionals who have designed or implemented complex information technology projects.

Innovative, experienced and technically proficient individuals are in great demand and are likely to remain a limited resource. There can be no assurance that we will be able to continue to attract and retain desirable executive officers and senior managers. Our inability to hire sufficient personnel on a timely basis or the loss of significant numbers of executive officers and senior managers could adversely affect our business.

**If we fail to establish and maintain important relationships with government entities and agencies, our ability to successfully bid for RFPs may be adversely affected.**

To facilitate our ability to prepare bids in response to RFPs, we rely in part on establishing and maintaining relationships with officials of various government entities and agencies. These relationships enable us to provide informal input and advice to the government entities and agencies prior to the development of an RFP. We also engage marketing consultants, including lobbyists, to establish and maintain relationships with elected officials and appointed members of government agencies. The effectiveness of these consultants may be reduced or eliminated if a significant political change occurs. We may be unable to successfully manage our relationships with government entities and agencies and with elected officials and appointees. Any failure to maintain positive relationships with government entities and agencies may adversely affect our ability to bid successfully in response to RFPs.

**The federal government may refuse to grant consents and/or waivers necessary to permit private entities, such as us, to perform certain elements of government programs.**

Under current law, in order to privatize certain functions of government programs, the federal government must grant a consent and/or waiver to the petitioning state or local agency. If the federal government does not grant a necessary consent or waiver, the state or local agency will be unable to outsource that function to a private entity, such as us, which could eliminate a contracting opportunity or reduce the value of a contract.

**Our business could be adversely affected by future legislative or government budgetary and spending changes.**

The market for our services depends largely on federal and state legislative programs and the budgetary capability to support programs, including the continuance of existing programs. These programs can be modified or amended at any time by acts of federal and state governments.

Moreover, part of our growth strategy includes aggressively pursuing new opportunities and continuing to serve existing programs scheduled for re-bid, which are or may be created by federal and state initiatives, principally in the area of health services, human services, and child welfare.

State budgets were adversely impacted by a general economic slowdown in fiscal 2003, creating state budget deficits, which trend has continued into fiscal 2004. All but one state must operate under a balanced budget. There are a number of alternatives to states in managing a possible budget deficit, including:

- Accessing previously set aside or "rainy day" funds;
- Increasing taxes;

- Elimination or reduction in services;

- Cost containment and savings;
- Pursuit of additional federal assistance; and
- Developing additional sources of revenue, such as the legalization of gaming.

We have experienced some reductions in program spending, fewer large outsourcing opportunities, some non-renewal of contracts, and some delays in contract signings as a result of the state budgetary situation. While we believe that the demand for our services remains substantial, and that some service offerings may experience increased demand in the current environment, continued state budget deficits may adversely impact our existing and anticipated business as well as our future financial performance.

Also, changing federal initiatives may have a significant impact on our future financial performance. Many state programs, such as Medicaid, are federally mandated and fully or partially funded by the federal government. Changes, such as program eligibility, benefits, or the level of federal funding may impact the demand for our services. Certain changes may present new opportunities to us and other changes may reduce the level of services provided by us, which would adversely impact our future financial performance.

**If we do not successfully integrate the businesses that we acquire, our results of operations could be adversely affected.**

Business combinations involve a number of factors that affect operations, including:

- diversion of management's attention;
- loss of key personnel;
- entry into unfamiliar markets;
- assumption of unanticipated legal or financial liabilities;
- becoming significantly leveraged as a result of incurring debt to finance an acquisition;
- unanticipated operating, accounting or management difficulties in connection with the acquired entities;
- impairment of acquired intangible assets, including goodwill; and
- dilution to our earnings per share.

As a result, we may be unable to profitably manage businesses that we have acquired or that we may acquire or we may fail to integrate them successfully without incurring substantial expenses, delays or other problems that could negatively impact our results of operations.

Also, customer dissatisfaction or performance problems with an acquired firm could materially and adversely affect our reputation as a whole. Further, the acquired businesses may not achieve the revenue and earnings we anticipated.

**Federal government officials may discourage state and local governmental entities from engaging us, which may result in a decline in revenue.**

To avoid higher than anticipated demands for federal funds, federal government officials occasionally discourage state and local authorities from engaging private consultants to advise them on maximizing federal funding. If state and local officials are dissuaded from engaging us for revenue maximization services, we will not receive contracts for, or revenue from, those services.

**We face competition from a variety of organizations, many of which have substantially greater financial resources than we do; we may be unable to compete successfully with these organizations.**

Our Health Services segment and Human Services segment compete for program management contracts with the following:

- government services divisions of large organizations such as Affiliated Computer Services, Inc., Electronic Data Systems, Inc., Accenture and Tier Technologies;
- specialized service providers such as Policy Studies Incorporated; and
- local non-profit organizations such as the United Way, Goodwill Industries and Catholic Charities.

Our Human Services segment also competes with specialized consulting firms.

Our Technical Services segment competes with a large number of competitors, including Unisys, SAP, Oracle, Bearing Point, Accenture, Litton PRC (a Northrop Grumman Company) and Electronic Data Systems, Inc.

Many of these companies are national and international in scope and have greater resources than we have. Substantial resources could enable certain competitors to initiate severe price cuts or take other measures in an effort to gain market share. In addition, we may be unable to compete for the limited number of large contracts because we may not be able to meet an RFP's requirement to obtain and post a large cash performance bond. Also, in some geographic areas, we face competition from smaller consulting firms with established reputations and political relationships. There can be no assurance that we will be able to compete successfully against our existing or any new competitors.

**Government responses to the terrorist attacks on September 11, 2001, the ongoing war on terrorism, and any additional terrorist activity could adversely affect our business.**

In response to the terrorist attacks in the United States on September 11, 2001, federal, state and local government agencies have incurred costs to plan and implement various security measures. We expect that all levels of government will continue to incur significant costs responding in various ways to the continuing threat of additional acts of terrorism, including possible reprisals against the United States resulting from its pursuit of the war on terror, or any such acts if they occur. To the extent that these government expenditures take precedence over other priorities in federal, state or local budgeting, then the amounts allocated by governments to purchases of the non-security services we offer may be reduced or reallocated, which would adversely affect our business and results of operations. We are unable to predict whether the threat of terrorism or the responses thereto will result in any long-term adverse effect on our business, results of operation or financial condition.

**A number of factors may cause our cash flows and results of operations to vary from quarter to quarter.**

Factors which may cause our cash flows and results of operations to vary from quarter to quarter include:

- the terms and progression of contracts;
- the levels of revenue earned and profitability of fixed-price and performance-based contracts (including any adjustments in expectations for revenue recognition on certain fixed-price contracts);
- expenses related to certain contracts which may be incurred in periods prior to revenue being recognized;
- the commencement, completion or termination of contracts during any particular quarter;
- the schedules of government agencies for awarding contracts;
- the term of awarded contracts; and
- potential acquisitions.

Changes in the volume of activity and the number of contracts commenced, completed or terminated during any quarter may cause significant variations in our cash flows and results of operations because a large amount of our expenses are fixed.

**Our stock price is volatile.**

Between October 1, 2001 and August 3, 2004, the sales price of our common stock has ranged from a high of $44.75 per share to a low of $18.25 per share. The market price of our common stock could continue to fluctuate

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substantially due to a variety of factors, including:

- quarterly fluctuations in results of operations;
- the failure to be awarded a significant contract on which we have bid;
- the termination by a government customer of a material contract;
- the announcement of new services by competitors;
- political and legislative developments adverse to the privatization of government services;
- changes in or failure to meet earnings estimates by securities analysts;
- sales of common stock by existing shareholders or the perception that these sales may occur;
- adverse judgments or settlements obligating us to pay damages;
- negative publicity; and
- loss of key personnel.

In addition, overall volatility has often significantly affected the market prices of securities for reasons unrelated to a company's operating performance. In the past, securities class action litigation has often been commenced against companies that have experienced periods of volatility in the price of their stock. Securities litigation initiated against us could cause us to incur substantial costs and could lead to the diversion of management's attention and resources.

**Our articles of incorporation and bylaws include provisions that may have anti-takeover effects.**

Our Articles of Incorporation and bylaws include provisions that may delay, deter or prevent a takeover attempt that shareholders might consider desirable. For example, our Articles of Incorporation provide that our directors are to be divided into three classes and elected to serve staggered three-year terms. This structure could impede or discourage an attempt to obtain control of us by preventing stockholders from replacing the entire board in a single proxy contest, making it more difficult for a third party to take control of us without the consent of our board of directors. Our Articles of Incorporation further provide that our shareholders may not take any action in writing without a meeting. This prohibition could impede or discourage an attempt to obtain control of us by requiring that any corporate actions initiated by shareholders be adopted only at properly called shareholder meetings.

**Our chief executive officer owns sufficient shares of our common stock to significantly affect the results of any shareholder vote.**

At August 3, 2004, our Chief Executive Officer, Dr. David Mastran, beneficially owns approximately 11.8% of our common stock. As a result, Dr. Mastran has the ability to significantly influence the outcome of matters requiring a shareholder vote, including the election of the board of directors, amendments to our organizational documents, or approval of any merger, sale of assets or other major corporate transaction. The interests of Dr. Mastran may differ from the interests of our other shareholders, and Dr. Mastran may be able to delay or prevent us from entering into transactions that would result in a change in control, including transactions in which our shareholders might otherwise receive a premium over the then-current market price for their shares.