SM&A
Form 10-K/A
May 15, 2006

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K/A
AMENDMENT NO. 1

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

For the fiscal year ended December 31, 2005

OR

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

For the transition period from __________ to __________

Commission file number 0-23585
SM&A
(Exact name of registrant as specified in its charter)

California	**33-0080929**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

4695 MacArthur Court, 8th Floor, Newport Beach, California 92660
(Address of principal executive offices) (Zip Code)
(949) 975-1550
(Registrant s telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act: None
Securities registered pursuant to Section 12(g) of the Act:
Common Stock, no par value
(Title of Class)

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

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

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 þ No o

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

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

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o

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

The aggregate market value of the voting and non-voting common equity held by nonaffiliates of the registrant was approximately $139,089,000 as of June 30, 2005.

Number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date: Common Stock, 19,838,460 shares outstanding at January 31, 2006.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s 2006 Proxy Statement are incorporated by reference into Part III of this Form 10-K.

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EXPLANATORY NOTE

SM&A (the Company) hereby amends its Annual Reports on Form 10 K for the fiscal year ended December 31, 2005 and December 31, 2004. The purpose of this Amendment No. 1 on Form 10-K/ A is to restate our consolidated financial statements for the years ended December 31, 2005 and 2004, respectively, and amend related disclosures, as described below and in the Notes to our Consolidated Financial Statements.

This amendment is related to the accounting for additional compensation expense resulting from the accounting for certain share repurchase transactions in accordance with Emerging Issues Task Force No. 00-23, *Issues Related to the Accounting for Stock Compensation under APB Opinion No. 25 and FASB Interpretation No. 44.* While the Company did fully disclose the transactions in its original Form 10-K filing (see related party footnote), and Item 13 (incorporated by reference to the proxy statement dated May 1, 2006) the Company failed to record the non-cash charge related to the transactions. SM&A is also filing this Amendment No. 1 to Form 10-K to correct errors in certifications under the Sarbanes-Oxley Act in its filing of February 24, 2006.

On May 12, 2006, the Audit Committee of the Board of Directors of the Company approved management s recommendation that the Company s financial statements for the three months ended December 31, 2004 and the three and six months ended June 30, 2005, and the years ended December 31, 2005 and 2004 be restated due to an error in the accounting for stock option expense.

The following Items and Exhibit have been amended in this Amendment No. 1.

Part II Item 6 Selected Financial Data

Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations

Part II Item 8 Financial Statements and Supplementary Data

Part III Item 9A Controls and Procedures

Part IV Item 15 Exhibits and Financial Statement Schedules

Exhibit 31.1 Certification of Chief Executive Officer

Exhibit 31.2 Certification of Chief Financial Officer

The following items are incorporated by reference from the Company s proxy statement dated May 1, 2006.

Item 10 Directors and Executive Officers of the Registrant

Item 11 Executive Compensation

Item 12 Security Ownership of Certain Beneficial Owners and Management

Item 13 Certain Relationships and Related Transactions

Item 14 Principal Accountant Fees and Services

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CAUTIONARY STATEMENT RELATED TO FORWARD LOOKING STATEMENTS

This Annual Report on Form 10-K includes certain forward-looking statements as defined within Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, relating to revenue, revenue composition, earnings, projected plans, performance, contract procurement, demand trends, future expense levels, trends in average headcount and gross margins, and the level of expected capital expenditures. Such forward-looking statements are based on the beliefs of, estimates made by, and information currently available to SM&A management and are subject to certain risks, uncertainties and assumptions. Any statements contained herein (including without limitation statements to the effect that the Company or management estimates, expects, anticipates, plans, believes, projects, continues, may, will, could, or would or statements concerning potential or opportunity or variations thereof or comparable terminology or the negative thereof) that are not statements of historical fact should be construed as forward-looking statements. The actual results of SM&A may vary materially from those expected or anticipated in these forward-looking statements. The realization of such forward-looking statements may be impacted by certain important unanticipated factors including those discussed in Risk Facotrs under Item 1A, and Management s Discussion and Analysis of Financial Condition and Results of Operations, at pages 16-20. Because of these and other factors that may affect SM&A s operating results, past performance should not be considered as an indicator of future performance, and investors should not use historical results to anticipate results or trends in future periods. The Company undertakes no obligation to publicly release the results of any revisions to these forward-looking statements that may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Readers should carefully review the risk factors described in this and other documents that SM&A files from time to time with the Securities and Exchange Commission (SEC), including subsequent Current Reports on Form 8-K, Quarterly Reports on Form 10-Q and Annual Reports on Form 10-K.

HOW TO OBTAIN SM&A SEC FILINGS

All reports filed by SM&A with the SEC are available free of charge via EDGAR through the SEC website at www.sec.gov. In addition, the public may read and copy materials filed by the Company with the SEC at the SEC s public reference room located at 450 Fifth St., N.W., Washington, D.C. 20549. SM&A also provides copies of its Forms 8-K, 10-K, 10-Q, Proxy and Annual Report at no charge to investors upon request and makes electronic copies of its most recently filed reports available through its website at www.smawins.com as soon as reasonably practicable after filing such material with the SEC.

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ITEM 1¾BUSINESS

As used in this report, SM&A, the Company , we, our and similar terms include SM&A and its subsidiaries, unless the context indicates otherwise.

Overview Development of Business

SM&A is the world s leading provider of Competition Management (business capture and proposal development) services, and a leading provider of Performance Assurance (post-award risk mitigation and profit maximizing) services. Under these two service lines, our approximately 300 employees and consultants provide strategy, proposal management, program management, systems engineering, program planning, and other high-value technical support to major industrial customers in the defense, homeland security, aerospace, information technology, and engineering sectors.

We were founded in 1982 and are a California corporation. After sixteen years of consistent revenue and profit growth, we completed an initial public offering in January 1998 and embarked on an acquisition program to broaden our service and product offerings. Due to the underperformance of the acquired businesses during 2000 and 2001, we discontinued, liquidated or sold all of the acquired businesses and, in early 2002, retired our debt.

Business Strategy

We support our clients by providing a full array of high-value services that either adds to our clients top line revenue through the more effective management of their proposals, and/or we improve their bottom line earnings by applying high value technical and management leadership to their awarded programs. While the Company operates in one business segment, our business strategy is to classify the services we offer under the following two categories:

Competition Management. Represents consulting services which provide project leadership to help our clients strategically position themselves, identify business opportunities, and formulate and prepare competitive bids. We are the largest provider of Competition Management services in the world; and

Performance Assurance. Represents consulting services that assist our clients in systems engineering and project integration tasks.

Competition Management

Competition Management. We provide Competition Management services through proprietary proposal management strategies and processes. In conjunction with these processes, we typically assume a leadership role and place dedicated teams at client facilities to manage all aspects of the competitive proposal development effort. Since 1982, we have managed more than 1,000 proposals worth more than $340 billion for our clients and have achieved an 85% win rate on awarded contracts. The combination of our high win rate and reputation has contributed to our dominant market share of Competition Management services outsourced by government contractors, while also leading to an increase in the amount of business from firms interested in winning commercial projects. The phases of our Competition Management services include:

The Pursuit Phase. Our team assists the client in the creation of a winning strategy that leads to the selection of sub-contractors, an investment plan, a technical baseline, and a program implementation plan. We typically deliver this support in the form of a small, very high-value team.

The Proposal Phase. Our team manages a client team, typically 10 to 200 engineers, information technology specialists and managers, providing full time, hands-on execution of the process from strategy formulation, through all phases of proposal preparation and review, to post-submittal responses to the government s questions. The proposal process typically requires three to twelve months of intense activity at the client s site.

The Evaluation Phase. After the proposal is submitted, the proposal team s interaction with the U.S. Government is a critical part of our winning process. Because our clients typically reassign key personnel to other projects after proposal submittal, we have an opportunity to support our clients with a small core team to answer formal questions from the government and prepare the best and final offer. Another area of our action during the government s proposal evaluation period is working with the client s team in preparation for winning the award. Many proposals include a very aggressive start-up phase that requires the delivery of significant products within the first 30 to 60 days after the contract award. We provide management support, program planners and schedulers, systems engineers, and other specialists to assist the client s team to meet early post-award commitments. This support leads naturally into the provision of program support services.

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Proposal Management Functions and Skills. We provide our clients with the full range of skills and functions they need to prepare winning proposals. As we have grown, we have provided a greater selection of services to our clients as they have concurrently grown more accustomed to outsourcing various proposal management functions.

The following provides some description of the types of services we deliver in support of Competition Management:

Win Strategist. Early in the competitive process, we help our clients position themselves to win. Win Strategists are typically senior SM&A associates with high-level executive backgrounds. Our account executives frequently participate in win strategy sessions for our clients.

Proposal Manager. The proposal manager is responsible for the timely execution of a client s proposal. He or she reports to an SM&A account executive. All SM&A and client personnel working on the proposal report to the SM&A proposal manager. SM&A proposal managers have strong technical and programmatic backgrounds and generally have had senior level responsibilities, such as vice presidents, general managers, program managers, or chief engineers before coming to work for us. SM&A only assigns individuals as proposal managers who have had significant prior experience with SM&A and our processes.

Executive Summary Author. When the proposal requires an executive summary, we often supply our clients with an author capable of fusing a wide array of topics into a compelling short story that explains why us? to the customer. These authors often have exceptional presentation expertise, and domain knowledge of the client s industry.

Technical Volume/Book Leader. The technical volume can be the most difficult part of a proposal because it forms the foundation of the client s offering, and usually involves the greatest number of client personnel. SM&A technical volume leaders have similar experience profiles to those of proposal managers.

Management Volume/Book Leader. Management volumes usually have fewer authors than technical volumes, but are of critical importance as they describe how the client will be organized to accomplish what has been proposed, who will actually lead the effort, and will determine the use of facilities, tools and processes, etc. As a result, SM&A management volume leaders may write more of this volume themselves. Management volume leaders are usually experienced industry senior managers.

Cost Volume/Book Leader. The cost volume leader often works with a large group of client accounting and cost estimating personnel. This task is challenging because the cost volume leader must understand both cost accounting and engineering principles.

Price-to-Win Support. This function often supports Win Strategy formulation as well as competitive pricing. Skills used include derivative pricing, parametric pricing, and competitive analysis.

Integrated Master Plan/Integrated Master Schedule Specialist. This specialist integrates the entire program: engineering, management, risk, schedule, and staffing. This skill is also in high demand in the program support services side of the business.

Orals Coach. If the proposal submittal has an oral presentation component, we will often support our client with intensive training and preparation. Orals coaches are highly experienced communications experts.

Production Leader. The production leader coordinates the physical creation of the proposal product, either in hard copy and/or in electronic format. The production leader is an experienced graphics artist with exceptional organizational and leadership skills.

Production Support. During times of intense proposal activity, clients are often understaffed in the area of graphics and word processing personnel. SM&A has a cadre of very experienced and high-quality production support personnel capable of working more quickly and to a higher level than can be obtained through temporary employment agencies or often the clients own staff.

Red Team Leader. Proposals will typically undergo one or more major reviews to ensure quality and consistency. Red Team leaders are senior level managers capable of organizing a very intense two- to three-day review process.

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Performance Assurance Services

Performance Assurance Services. Performance Assurance services comprise all aspects of successful program delivery. Since past performance (i.e., a company s contract performance) is a large part of the graded score in competitive federal procurements, our clients especially value our support in this area. Some notable examples of our program support services in 2005 are our ongoing assistance to The Boeing Company in support of its National Missile Defense Lead System Integrator responsibilities and Future Combat Systems program and our continued support to Lockheed Martin Corporation in service of its Joint Strike Fighter program. The types of services we provide include:

QuickStart®. Over the past 24 years, SM&A has identified twelve areas of reoccurring risk that our clients often fail to effectively address during the first six months of a program and developed a solution to assess, prioritize, and mitigate these and other risks. Our solution keeps programs on schedule and within budget parameters, ensuring the program gets off to a solid start.

AwardFee . Award fee is a contractual approach used by the buyer to motivate the contractor s performance areas deemed critical to the program s success (e.g. technical, logistics support, cost, and schedule) and is subjectively and qualitatively measured and evaluated. Our solution focuses resources according to the categories, weightings and criteria identified in the contract. Our approach is adapted from our Competition Management process to develop a winning strategy for each award fee evaluation period, improve program implementation, and ensure that every meeting, deliverable and customer communication reinforces the case for maximal award fee.

Program Management. Our cadre of experienced executives and program managers assist our clients in executing critical portions of their contract work. This assistance can take the form of interim management, an Integrated Product Team leader, or a sub-leader. In most cases, our leadership serves as a bridge until our client can find the appropriate person to lead the effort internally. In some cases, we are engaged as a subcontractor to provide management assistance for more extended periods of time.

Systems Engineering. Our systems engineering work in support of program execution assists our clients in defining the work that must be done to meet a given program s objectives. The first step formally defines the top-level program objectives including mission requirements, annual and total budget, and the schedule for each major program milestones and then communicates them to each engineering, information technology, and management department. The systems engineers perform trade studies and analyses to objectively evaluate the cost, schedule, risk and likely performance of alternative solutions. The systems engineers then manage the top-level program requirements database. As the program evolves through the design, development, test, and production phases, systems engineers constantly evaluate the work of the program s design and test groups to be certain that the top-level requirements are being met.

Program Integration. Concurrent with our delivery of systems engineering in support of program execution, we provide our program integration functions. We do this work to ensure that a given program has been meticulously planned and that the program team follows the plan. Our program integration effort is critical to the financial success of our client. The work has an initial phase in which the program to be accomplished is defined in detail. This includes the detailed description of all tasks to be completed by all of the participants over the life of the program, the scheduling of these tasks, the sizing of each task and the definition of the relationship among the tasks. This information is maintained by the program integration team in an electronic and, sometimes, web-enabled format easily accessible to the management team. After the definition work is completed, the program integration staff focuses on the execution of the program in which the status of each task is constantly evaluated and reported to management, including the government project office, the likely attainment of future milestones is predicted, and the program risks are constantly re-evaluated to allow proactive management decisions to mitigate risk.

Markets for Competition Management Services

We assist companies seeking to identify, win and implement new business. Since 1982, we have helped clients win contracts, a service that generated about 58% and 57% of our revenue in 2005 and 2004, respectively. Our major clients core businesses are in providing various defense and aerospace goods and services to the federal government and represent about 71% and 75% of our proposal management activity in 2005 and 2004, respectively. Our reputation in the market is based on our ability to help our clients win consistently. This reputation for winning provides us with an opportunity to provide new and existing clients with services beyond Competition Management.

We provide our clients with a full service strategic consulting and proposal management capability. The need for this specialized capability can be found wherever companies have a requirement to produce a competitive proposal in response to a request for proposal from a corporate, federal, state, local or international entity. We have also been marketing with increasing success to companies pursuing non-federal business. The largest single portion of our business is derived from supporting companies engaged in the pursuit of competitively awarded federal contracts, mainly from the Department of Defense (DoD).

Supporting Proposals in Response to Federal Procurements. According to the Government Electronics and Information Technology Association (GEIA), the federal government will obligate approximately $157 billion in fiscal year 2006 to acquire goods and services from large prime contractors, of which approximately two-thirds to three-quarters will be obligated by the DoD. Federal spending of this nature is expected to remain level in 2006 and may continue at this rate for another two to three years due to resources constrained by the global war on terror, current operations in Iraq and Afghanistan, and current federal deficit pressures. A significant portion of these funds will be spent on information technology goods and services. Much of this procurement spending will be awarded competitively. Companies generally spend from one-half of one percent to three percent of the expected value of a contract to prepare their proposals. A company may therefore spend from $500,000 to $2 million to prepare a proposal for a program valued at $100 million. Federal law and policy encourages this spending and allows companies to seek reimbursement for about 50% of these expenses. Some portion of the money spent to bid on a program is often outsourced and it is this outsourcing for proposal services that represents the majority of our traditional source of revenue. Furthermore, the spending cited above is happening during a time of extreme demographic pressures in the defense and aerospace industry. The defense contractor workforce is retiring in record numbers up to 30% of defense industry knowledge workers are expected to retire between 2003 and 2007. To meet new demand and replace retiring workers, we believe the defense industry will have to hire about 255,000 knowledge workers between now and 2007. For this reason alone we can expect continued outsourcing demand from our clients. Finally, as part of our support to clients in leading the development of a competitive proposal, we often provide competitive strategy services and management consulting services.

Supporting Proposals in Response to State and Local Procurements. According to Governing magazine, a subsidiary of Times Publishing, state and local governments will spend approximately $515 billion on goods and services in 2006. State and local service-based projects are generally smaller and less complex than federal projects, thus making the potential market for our services smaller in the state and local market than in the federal market. As with non-DoD federal procurements, the larger and more complex state and local procurements often involve information technology and we have provided significant support to our clients in assisting the creation of their proposals for state and local government contracts.

Supporting Proposals in Response to International Government Procurements. Large international competitions, especially for defense goods among America s allies, are, in many ways, structured similarly to procurements managed by the DoD. We have enjoyed a significant degree of success and involvement with these overseas competitions over the years, especially with our established client base.

Supporting Proposals in Response to Corporate Procurements. We believe that large and technically complex corporate procurements have increasingly used a formal request for proposal rather than relationship selling to aid in determining the winning bidder. The processes and tools we developed for helping clients win government contracts are largely applicable in this market as well.

We project that the U.S. market for our proposal services exceeds $1 billion annually. This assessment is derived from our ongoing analysis of several recognized industry source documents and includes revenues we expect to be generated from DoD, civil, state and local government procurement awards for U.S. based large business concerns (excludes dollars set aside for small business firms).

Factors Driving Growth in Competition Management Services

We believe the growth of the market for outsourced proposal management is dependent on a number of factors, including but not limited to:

An Increase in the Defense Spending Budget. The defense budget is growing in some areas as the need for modernization of aging equipment becomes more pressing, and America s war on terrorism continues. The latter factor will drive defense spending for the foreseeable future. Furthermore, while defense spending appears likely to increase for the next few years, it is important to understand the distinction between spending on ongoing operations and spending on new systems and research and development the former type of spending is not as beneficial to us as it does not generally result in new competitive procurements.

The ongoing expansion of Department and Homeland Security responsibilities and its role in the Global War on Terror (GWOT) should also continue to drive increasing need for proposal management services on Federal procurement opportunities.

An Increase in the Importance of Proposal Management Services. We believe that various factors in the aerospace and defense industries are contributing to an increased need to win projects. The ongoing consolidation activity in these industries has resulted in fewer, larger firms as well as an increased disparity between the resources of these larger firms and the remaining relatively smaller firms. The large consolidated firms are more motivated to win programs to support their operations and the smaller firms have an even greater need to access the resources necessary to compete with larger firms for programs. The U.S. Government has also conducted a number of winner-take-all competitions in which the government chose a single winner from two or more large aerospace suppliers that had historically supplied the products or services. The winners received multi-billion dollar contracts while the losers were either allocated a program subcontract or required to shut down their production facilities and re-assign or lay off several thousand workers. Consequently, proposal management services and a winning outcome have become increasingly crucial to all competitors.

A Decrease in Internal Competitive Proposal Capabilities of Client Community. We believe that the internal proposal capabilities of the clients we have targeted for selling services to has decreased over the last several years due to fiscal pressures exerted on these companies. This trend is expected to accelerate as the pace of retirements within our client community peaks in the next five years creating additional opportunities for proposal related services.

Markets for Performance Assurance Services

The access to key industry decision makers provided by the successful conclusion of a proposal often gives us the ability to provide Performance Assurance services to our clients. The early stages of a large or complex program are often the most critical. Our familiarity with the program, developed during the proposal phase, can compel our clients to hire us to ensure a rapid and successful program start. Services provided include systems engineering, program management, and project integration.

We offer program support services as a direct result of client requests to provide such services beginning in the mid-1990s. This service generated about 42% and 43% of our revenue in 2005 and 2004, respectively. The size of this market is in the billions of dollars annually, much of it in support of DoD prime contractors executing research, development, test and evaluation (RDT&E) contracts. According to DoD, in fiscal year 2005, the top 100 DoD contractors provided $163 billion of the $269 billion of goods and services contracted to business, of which about $37 billion was in support of RDT&E programs (see: www.defenselink.mil/pubs/almanac). Typically, prime contractors subcontract between 40-70% of the work share on such efforts. NASA, the Department of Energy and large federal and state information technology programs provided added value to this market numbering in the billions of dollars annually.

One prime entry point into these markets is through established clients with whom we have built a solid relationship based on winning important programs and trust. Several times a year we help our clients win new business. This often provides us with an opportunity to grow a successful business relationship from delivering proposal support services to delivering a wider range of services for our clients.

Factors Driving Growth in Performance Assurance Services

Strong client relations developed and maintained through program support, management consulting, and competitive strategy services also enhance our ability to provide proposal management services to our clients. We believe we can successfully compete in these markets by using our reputation for winning to access potential clients, and then provide those clients with a wide range of services based on our experienced workforce, disciplined processes, and understanding of complex systems.

As previously mentioned, our client base is under demographic pressures. Increased demand for goods and services for defense and homeland security purposes factored in with the accelerating pace of retirements in the industry indicates a shortfall of some 255,000 knowledge workers from 2003 through 2007. About half of this shortfall is due to retirements and half is due to increased demand. We primarily recruit new workers from the ranks of the best and brightest of the newly retired aerospace and information technology community. We believe the industry s experienced personnel challenge is our opportunity. Further analysis can be found in the November 2002 report of the Federal *Commission on the Future of the United States Aerospace Industry* (see: www.aerospacecommission.gov/AeroCommissionFinalReport.pdf) which says, in part, The industry is confronted with a graying workforce in science, engineering and manufacturing, with an estimated 26 percent available for retirement within the next five years. New entrants to the industry have dropped precipitously to historical lows as the number of layoffs in the industry mount. Compounding the workforce crisis is the failure of the U.S. K-12 education system to properly equip U.S. students with the math, science, and technological skills needed to advance the U.S. aerospace industry. This latter point is particularly important as foreign nationals have a difficult time obtaining the required security clearances to work in the defense and homeland security industries.

Sales and Marketing

Our account executives market our services directly to senior executives of major corporations, supported as necessary by our leadership and staff. Our account executives are experienced industry experts who have successfully managed proposal development efforts and/or have extensive sales experience in professional services. They spend the majority of their time on-site with our clients,

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working with them to capture and implement new business. Relationship selling based on this on-site presence along with our excellent reputation drives most of our revenue.

Specifically addressing our currently targeted client base, SM&A has developed a tracking process that now includes more than 130 major business units of our core defense as well as other associated firms. These firms represent where we derive our existing revenues as well as where we are targeting additional growth. Of these 130 plus major business units, we estimate that our services are only made available in 15 to 20 percent of the competitive bidding opportunities. Even at this service level, actual revenue as a percent of targeted revenue from these businesses has been increasing. Furthermore, as we continue to strategically manage the addition of experienced Account executives and focus on specific targeted client business units, we expect increased opportunities for revenue generation at current clients will occur and development of new client revenue opportunities will develop.

A significant portion of new business arises from prior client engagements. Clients frequently expand the scope of engagements during delivery to add complementary activities. Also, our on-site presence affords our team the opportunity to become aware of, and to help define, additional project opportunities as they are identified by the client. The strong client relationships arising out of many engagements facilitate our ability to market additional services to our clients in the future. In addition, our senior management team is actively involved in meeting with companies that have not yet engaged our services, and newly appointed senior managers in existing clients who might not be thoroughly knowledgeable of our previous assistance to them.

In addition to relationship selling, we employ a variety of business development and marketing techniques to communicate directly with current and prospective clients, including making on-site presentations, advertising in trade publications, attending industry seminars often featuring presentations by our personnel, attending trade shows and authoring articles and other publications about the industry and our methodologies, processes and technologies.

Major Clients

We provide our high-end systems engineering and integrated proposal management services to numerous Fortune 100 clients. Our largest clients by percent of revenue received for the year ended December 31, 2005 are:

The Boeing Company	27.4%
Accenture LTD	20.5
Lockheed Martin Corporation	14.6
	62.5%

This revenue is a result of various engagements by several business units of these companies. Although such business units are affiliated with the parent entities, our experience indicates that particular engagements are subject to the discretion of each individual business unit.

Pipeline and Backlog Process

Generally, our contracts are terminable by the client on short notice or without notice. Accordingly, we do not believe it is appropriate to characterize these contracts as backlog. Normally if a client terminates a project, the client remains obligated to pay for commitments we have made to third parties in connection with the project, services performed and reimbursable expenses incurred by us through the date of termination.

We estimate our future performance based on pipeline. Pipeline is defined as measuring specific opportunities in our marketplace and assigning an estimated percentage of obtaining the opportunities. These internal estimates, though useful for planning purposes, are subject to a number of risks and uncertainties, and our actual results may frequently be materially different from our pipeline estimates set from time to time.

Competition

We are a niche player providing high-value strategic services that, in most cases, would not be otherwise outsourced. As a result, we most frequently compete with our clients internal organizations. We believe our core clients continue to labor under demographic pressures and, as a result, their ability to internally staff their requirements for high-value resources will diminish. In addition to our clients internal capability, we have competitors in our markets for both competition management and performance assurance services. Competitors in the competition management services are made up of very small consultancies and individual consultants focusing primarily on proposal development. The largest of these is approximately one-fifth our size. We are able to offer greater depth of capability, a more diversified array of capabilities, and more efficient, better structured processes. We continue to focus on the strategic issues driving our clients ability to win and high quality execution of their proposals. Competitors for performance assurance services are by contrast generally very large companies, many have greater marketing, technical, and financial resources than ours. However, our goal is not to be the high volume provider of journeyman technical support, but rather to be the premium provider of high-value strategic support services. Our focus is on delivering very high quality, something that is very difficult for high volume providers to deliver.

Competition Management Services. Our biggest competitor in this market is our clients internal competition management capability. Many of our clients maintain internal business acquisition teams that are designed to handle the procurement of government contracts. The number of such in-house departments has been decreasing in recent years and, therefore, these clients have a limited ability to react to sudden increases in procurement activity or to must-win situations. If the client is open to outsourcing, then we are the largest provider of outsourced Competition Management services and principally compete with numerous smaller companies in this highly specialized industry. Shipley Associates is our largest competitor with 16% of our revenue in 2003, according to Dunn & Bradstreet.

Performance Assurance Services. The program management, systems engineering and program integration markets are highly competitive and include a large number of highly capable firms in the United States with internal resources of the larger prime contractors being the primary competition. The market is also highly fragmented. We, however, have found increasing opportunities to work with clients who have previously retained us for proposal management services. In doing so, we seek to provide high-value strategic services as opposed to simply providing engineering job shop services as our competitors usually do. Some of our competitors include Booz Allen Hamilton and Volt Information Technology.

Principal Competitive Factors in Professional Services. We believe the principal competitive factors in the professional business services market includes, in priority order: industry and program knowledge, rapidly deployable skilled personnel, responsiveness, reputation, credibility, reliability, and price. Proposal management competitive factors are similar but in a different priority, they include: reputation, the level of experience and skill of staff professionals, credibility, reliability, industry expertise, quality of service, responsiveness, and procurement success rate. The need to provide efficient and cost-effective service is of even greater importance where the cost of proposal development is likely to be a larger percentage of the contract amount than with a large program.

Development of New Services or Techniques

In 2005, we introduced two new solutions, QuickStart® and AwardFee . We plan to continue to develop, sell and deliver new complementary service line extensions that will service our existing and new customers. We plan to rollout these service lines extensions throughout 2006 and we will continue to evaluate additional opportunties as they are identified.

In addition, we are investing in hiring personnel capable of rapidly setting up and working in collaborative computer networks increasingly valuable skills needed to support our clients. Furthermore, as proposals have more commonly become electronic rather than paper, we have developed techniques to improve quality and the ease at which the proposal can be evaluated by the government.

Employees

As of December 31, 2005, we had approximately 300 employees and consultants. Approximately 81% of the employees are Competition Management and Performance Assurance consulting professionals, 7% are account executives and marketing professionals and the remaining 12% are involved in enterprise management which comprises finance, management information systems, human resources and other administrative functions. We believe that our success depends significantly upon attracting, retaining and motivating talented, innovative and experienced professionals. For this reason, our employees are comprised of experienced program managers, engineers and skilled technicians, tested in some of the largest and most complex military, commercial and government programs of the past 30 years. The typical employee has more than 20 years of applicable experience in industry, government and/or the military and a majority of our employees possess advanced degrees in science, engineering or information technology fields.

We have a recruitment and training program to help acquire and ensure retention of high quality personnel and to enable us to respond to expanding customer needs. The performance of each of our employees is continuously evaluated both by the team with whom the employee is working and by the client who has engaged us. Our executives are always on call to discuss any and all personnel issues. We have maintained the highest standards of performance to ensure client satisfaction. We also attract and motivate our professional and administrative staff by offering competitive packages of base salary and incentive compensation and benefits.

Our employees are not represented by any labor union and we have never experienced a work stoppage. We believe that our relations with our employees are good.

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ITEM 1A¾RISK FACTORS

ADDITIONAL FACTORS THAT MAY AFFECT FUTURE RESULTS

In addition to the other information in this Annual Report on Form 10-K, the following factors should be considered carefully in evaluating our business and prospects.

Our business depends substantially on the defense industry.

Our competition management and performance assurance services business depends substantially on U.S. Government expenditures for defense products. Any decline in the future defense, information technology or homeland security procurement expenditures could affect the opportunities available to our clients and, indirectly, our business. A number of factors could contribute to such a decline in opportunities, including:

- Loss of political support for current or increased levels of spending;
- Changes of presidential administration, particularly changes from one political party to another, that typically result in a mass reordering of priorities that reduce new proposal activity for up to a year;
- Threat scenarios evolving away from global conflicts to regional conflicts;
- Spending for ongoing operations, such as the war on terrorism, the occupation of Iraq, downward pressure on spending for procurement of new systems and research and development spending; and
- Cancellation of programs or emphasis on government shifting programs.

In the event expenditures for products of the type manufactured by our clients are reduced and not offset by other new programs or products, there will be a reduction in the volume of contracts or subcontracts to be bid upon by our clients and, as a result, a reduction in the volume of proposals we manage. Unless offset, such reductions could materially and adversely affect our business, operating results and financial condition.

We rely on a relatively limited number of clients.

We derive a significant portion of revenue from continuing operations from a relatively limited number of clients. Our seven largest customers accounted for 80.2% and 83.5% of our revenue for 2005 and 2004, respectively. Clients typically retain our services as needed on an engagement basis rather than pursuant to long-term contracts, and a client can usually terminate the engagement at any time without a significant penalty. Moreover, there can be no assurance that existing clients will continue to engage us for additional assignments or do so at the same revenue levels. The loss of any significant client could materially and adversely affect our business, financial condition and results of operations. In addition, the level of services required by an individual client may diminish over the life of the relationship, and there can be no assurance we will be successful in establishing relationships with new clients as this occurs.

The markets in which we operate are highly competitive.

The market for competition management services in the procurement of government and commercial contracts for aerospace and defense work is a niche market with a number of competitors. We are the largest provider of such services and principally compete with the in-house capability of our clients. In addition, numerous smaller proposal management companies compete in this highly specialized industry. With sufficient resources in the form of money and excellent talent with current security clearances, our competitors could erode our current market share and such a reduction could materially and adversely affect our business, operating results and financial condition.

We rely heavily upon our key senior management personnel and our ability to recruit and maintain skilled professionals.

Our success is highly dependent upon the efforts, abilities, and business generation capabilities and project execution of our strategic account managers and account executives. In addition, Steven S. Myers, our Chief Executive Officer and Chairman of the Board, has a significant role in our success. The loss of the services of these individuals, for any reason, could materially and adversely affect our business, operating results and financial condition.

Our business involves the delivery of professional services and is highly labor-intensive. Our success depends largely on our general ability to attract, develop, motivate and retain highly skilled professionals. The loss of some or a significant number of our professionals or the inability to attract, hire, develop, train and retain additional skilled personnel could have a serious negative effect on us, including our ability to obtain and successfully complete important engagements and thus maintain or increase our revenue.

Quarterly results may fluctuate.

We may experience fluctuations in future quarterly operating results due to a number of factors, including the size, timing and duration of client engagements.

Our stock price is subject to significant volatility.

Our common stock was first publicly traded on January 29, 1998 after our initial public offering at $12.00 per share. Between January 29, 1998 and December 31, 2005, the closing sale price has ranged from a high of $31.13 per share to a low of $0.75 per share. The market price of our common stock could continue to fluctuate substantially due to a variety of factors, including:

- Quarterly fluctuations in results of operations;
- Adverse circumstances affecting the introduction, or market acceptance of new services we offer;
- Announcements of new services by competitors;
- Announcements of poor operating results by us or our competitors;
- Loss of key employees;
- Changes in the regulatory environment or market conditions affecting the defense and aerospace industry;
- Changes in earnings estimates and ratings by analysts;
- Lack of market liquidity resulting from a relatively small amount of public stock float;
- Changes in generally accepted accounting principles;
- Sales of common stock by existing holders; and
- The announcement of proposed acquisitions and dispositions.

We cannot guarantee that future acquisitions, mergers or investments in other companies will be successful.

If appropriate opportunities present themselves, we may consider acquiring, merging with or making investments in companies or assets that we believe will complement, enhance or expand our current business or otherwise offer us growth opportunities. We will likely compete for such opportunities with companies with greater financial and management resources than us. There can be no assurance that suitable acquisition or other investment opportunities will be identified, that any of these transactions can be consummated, or that, if acquired, the new businesses can be integrated successfully and profitably into our operations. These acquisitions and investments may also entail the following risks:

- the diversion of our management s attention from our existing business while evaluating acquisitions, investments and other prospective business combinations and thereafter while assimilating the operations and personnel of the new business;
- adverse short-term effects on our operating results;
- the inability to successfully and rapidly integrate the new businesses, personnel and products with our existing business, including financial reporting, management and information technology systems;
- higher than anticipated costs of integration;

unforeseen operating difficulties and expenditures;

the need to manage a significantly larger business;

potential dilution to our shareholders to the extent we use our common stock as currency for an acquisition;

the assumption of liabilities;

the use of a substantial amount of our available cash to consummate an acquisition;

difficulties inherent in the implementation and application of the provisions of the Sarbanes-Oxley Act of 2002 to the operations of a privately-held entity acquired by the Company; and

loss of employees of an acquired business, including employees who may have been instrumental to the success or growth of

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that business.

We may not be able to successfully integrate or operate profitably any new business we acquire and we cannot assure you that any other investments we make, or strategic alliances we enter into, will be successful.

Principal shareholder has significant control.

At December 31, 2005, Steven S. Myers, Chief Executive Officer and Chairman of the Board, beneficially owned or controlled approximately 22.7% of our outstanding common stock and will have the ability to control or significantly influence the election of directors and the results of other matters submitted to a vote of shareholders. This concentration of ownership may have the effect of delaying or preventing a change in control and may adversely affect the ability of other holders of our common stock to pass shareholder resolutions and control our actions. Our board of directors is currently comprised entirely of individuals nominated with the approval of Mr. Myers.

ITEM 1B UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2 PROPERTIES

We do not own any real estate. We lease our principal corporate offices adjacent to the John Wayne Airport in Newport Beach, California. We have approximately 31,000 square feet of office space in this location and the term of our lease expires in June 2012. Additionally, we have approximately 300 square feet of office space in Herndon, Virginia, which serves as our East Coast sales support office, the lease for which expires in April 2006. We believe our offices are adequate for our present and anticipated near-term need.

Included in discontinued operations are three properties totaling approximately 56,000 square feet. All of the 56,000 square feet have been subleased under non-cancelable leases.

ITEM 3 LEGAL PROCEEDINGS

We are involved in routine litigation incidental to the conduct of our business. There are currently no material pending litigation proceedings to which we are a party or to which any of our property is subject.

ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

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PART II

ITEM 5 MARKET FOR THE REGISTRANT S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

Price Range of Common Stock

On May 30, 2000 our Common stock began trading on the NASDAQ Small Cap Market under the symbol EITI following notification from NASDAQ that we did not comply with the requirements for continued listing on the NASDAQ National Market. In 2003, we were relisted to the NASDAQ National Market after we met the requirements for listing. On January 24, 2002, we changed our name to SM&A and our symbol to WINS .

The following table sets forth, for the quarters indicated, the high and low closing sale prices as reported on NASDAQ.

	2005		2004	
	High	**Low**	**High**	**Low**
First Quarter Ending March 31	$8.65	$7.54	$12.97	$10.00
Second Quarter Ending June 30	$9.19	$8.03	$11.14	$ 7.27
Third Quarter Ending September 30	$9.99	$8.49	$ 8.72	$ 6.59
Fourth Quarter Ending December 31	$9.10	$8.03	$ 8.94	$ 6.92

As of January 31, 2006, there were approximately 83 shareholders of record of our common stock. The closing sale price of our common stock on the NASDAQ National Market on January 31, 2006 was $7.21 per share.

Dividends

We have not declared or paid cash dividends to stockholders of our common stock. We do not anticipate paying cash dividends on our common stock in the foreseeable future. The payment of any future dividends will be at the discretion of our Board of Directors and will depend upon, among other things, future earnings, capital requirements, and our general financial condition.

Recent Sales of Unregistered Securities

None.

Shares Reserved for Future Issuance

At December 31, 2005, we had reserved 1,875,994 shares for future issuance under our stock option plan and 144,574 shares under our employee stock purchase plan.

Issuer Purchases of Equity Securities

In May 2004, the Company s Board of Directors authorized a plan to repurchase up to $7.0 million of the Company s common stock. In April and October 2005, the Company s Board of Directors authorized an increase of an additional $5.0 million and $8.0 million, respectively, increasing the total authorization to repurchase the Company s common stock to $20.0 million. In January 2006, the Company s Board of Directors authorized an increase of an additional $10.0 million of SM&A s common stock. The Company intends to repurchase shares from time to time, at prevailing prices, in the open market. The timing and amount of the share repurchases will be at the discretion of management and will be based on such factors as the stock price, general economic and market conditions, and other factors. The share repurchase plan may be suspended or discontinued at any time. Shares repurchased under the plan are cancelled. As of December 31, 2005, we have repurchased 1,813,166 shares at a total cost of $14.7 million.

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ITEM 5 MARKET FOR THE REGISTRANT S COMMON STOCK AND RELATED STOCKHOLDER MATTERS (continued)

Included in the table below are the block transactions for shares repurchased at a discounted cost, which the Company facilitated the exercising of stock options and the purchase of the related shares upon the retirement of former members of the Board of Directors and the resignation of the former President and Chief Operating Officer.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of a Publicly Announced Plan	Approximate Dollar Value of Shares That May Yet Be Purchased Under The Plan
Beginning balance		$		$ **7,000,000**
May 1, 2004 to June 30, 2004	34,200	8.01	34,200	6,726,138
July 1, 2004 to September 30, 2004	297,800	7.42	332,000	4,515,481
October 1, 2004 to December 31, 2004	293,500	7.29	625,500	2,377,097
January 1, 2005 to March 31, 2005	73,170	7.97	698,670	1,793,675
April 1, 2005 to June 30, 2005	351,825	8.24	1,050,495	3,896,192
July 1, 2005 to September 30, 2005	22,000	8.84	1,072,495	3,701,703
October 1, 2005 to December 31, 2005	740,671	8.62	1,813,166	5,317,099
Total	**1,813,166**	$ **8.10**	**1,813,166**	$ **5,317,099**

Information about securities authorized for issuance under the Company s equity compensation plans is incorporated by reference to Note 8 to the Financial Statements.

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ITEM 6 SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with the consolidated financial statements and notes thereto and the information contained herein in Item 7 of Part II, Management s Discussion and Analysis of Financial Condition and Results of Operations. Historical results are not necessarily indicative of future results.

	Years Ended December 31, (in thousands, except per share data)				
	As Restated 2005	As Restated 2004	2003	2002	2001
Consolidated Statements of Operations Data:					
Revenue	$ 76,711	$ 68,954	$ 75,593	$ 55,057	$ 46,407
Gross margin	32,008	31,193	34,060	22,998	19,360
Operating income	10,436	14,298	19,731	10,629	7,347
Interest (income) expense, net	(586)	(192)	(73)	865	1,909
Unrealized (gain) loss on interest rate swap				(6)	673
Income from continuing operations	7,081	9,435	13,268	6,518	2,849
(Loss) from discontinued operations					(21,897)
Cumulative effect of adoption of FASB Statement No.133, net of tax					(668)
Extraordinary loss from early extinguishment of debt, net of tax				(2,499)	
Net income (loss)	$ 7,081	$ 9,435	$ 13,268	$ 4,019	$ (19,716)
Net income (loss) per share*:*					
Basic					
Continuing operations	$ 0.35	$ 0.46	$ 0.66	$ 0.33	$ 0.15
Discontinued operations	$	$	$	$	$ (1.15)
Extraordinary loss from early extinguishment of debt	$	$	$	$ (0.13)	$
Cumulative effect of adoption of FASB Statement No. 133	$	$	$	$	$ (0.04)
Net income (loss)	$ 0.35	$ 0.46	$ 0.66	$ 0.21	$ (1.04)
Diluted					
Continuing operations	$ 0.34	$ 0.44	$ 0.62	$ 0.32	$ 0.15
Discontinued operations	$	$	$	$	$ (1.14)
Extraordinary loss from early extinguishment of debt	$	$	$	$ (0.12)	$
Cumulative effect of adoption of FASB Statement No. 133	$	$	$	$	$ (0.03)
Net income (loss)	$ 0.34	$ 0.44	$ 0.62	$ 0.20	$ (1.03)
Shares used to calculate net income (loss) per share:					

Basic	20,271	20,428	19,991	19,535	19,045
Diluted	20,797	21,521	21,428	20,452	19,219
Consolidated Balance Sheet Data:					
Cash	$ 19,103	$ 22,148	$ 17,712	$ 5,956	$ 26,270
Investments	4,950				
Working capital	32,824	31,860	23,833	7,917	4,470
Total assets	38,742	37,383	31,803	18,404	44,691
Long-term debt, including current portion					22,085
Shareholders equity	34,860	32,691	24,433	8,388	3,685

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ITEM 7 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Critical Accounting Policies and Estimates

SM&A s discussion and analysis of its financial condition and results of operations are based upon SM&A s consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. Note that preparation of this Annual Report on Form 10-K requires SM&A to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of its financial statements, and the reported amounts of revenue and expenses during the reporting period. SM&A bases its 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 that are not readily derived from other sources. There can be no assurance that actual amounts will not differ from those estimates.

SM&A has identified the policies below as critical to its business operations and the understanding of its results of operations.

Revenue Recognition. The Company recognizes revenue from services rendered when the following four revenue recognition criteria are met: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the selling price is fixed or determinable, and collectibility is reasonably assured. The majority of the Company s services are provided under time and expenses billing arrangements and revenue is recognized on the basis of hours utilized, and other reimbursable contract costs incurred during the period. Revenue is directly related to the total number of hours billed to clients and the associated hourly billing rates. A limited amount of revenue is also derived from success fees offered to clients as a pricing option, and recorded as revenue only upon the attainment of the specified incentive criteria. Success fees are not billable and revenue is not recorded until the customer wins a contract.

Use of Estimates. The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Estimates made in preparing the financial statements include the allowance for doubtful accounts, reserves for discontinued operations, and income tax valuation allowances.

Allowance for Doubtful Accounts. Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of accounts receivable. The Company s accounts receivable are derived from revenue earned from customers primarily in the United States. The majority of the Company s receivables are from large companies in the aerospace and defense industries. The Company controls credit risk through credit approvals and monitoring procedures and, generally, does not require collateral or other security to support financial instruments subject to credit risk. Management must make estimates regarding the collection of its accounts receivable. Management specifically analyzes accounts receivable and analyzes historical bad debts, customer concentrations, customer credit-worthiness, current economic trends, and changes in its customer payment terms when evaluating the adequacy of the allowance for doubtful accounts.

Overview

SM&A is the world s leading provider of Competition Management (business capture and proposal development) services, and a leading provider of Performance Assurance (post-award risk mitigation and profit maximizing) services. Under these two service lines, our approximately 300 employees and consultants provide strategy, proposal management, program management, systems engineering, program planning, and other high-value technical support to major industrial customers in the defense, homeland security, aerospace, information technology, and engineering sectors. Since 1982, we have managed more than 1,000 proposals worth more than $340 billion for our clients and have achieved an 85% win rate on awarded contracts.

We have traditionally been heavily concentrated in the aerospace and defense sector which leaves us susceptible to market fluctuations caused by events such as the war on terrorism and election year uncertainties. In 2003 we initiated a strategic goal of diversifying ourselves outside of our traditional aerospace and defense concentration by offering our services to new customers in new verticals. Our efforts have produced strong results as discussed below.

Market Diversity. Starting in late 2003, we focused our sales and marketing efforts to expand into primarily the State and Local Information Technology market. During fiscal 2005, 2004 and 2003, this market contributed to $22.6 million, $17.2 million, and $12.1 million or 29%, 25%, and 16% of our revenues, respectively.

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ITEM 7 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

Customer Diversity. During fiscal 2005, 2004 and 2003, three of our clients accounted for more than 10% of the Company s total revenues. Revenues from the three clients in 2005, 2004, and 2003 represented $48.0 million, $47.2 million, and $53.3 million or 63%, 69% and 77% of total revenues. While our reliance on our top three clients has been declining, a loss of one or more of these major clients, a decrease in orders by one or more of these clients or a change in the combination of services purchased by one or more these clients could adversely affect our revenues, net income and margins.

Solution Development. During fiscal 2005, we started to develop two new service solutions that both complement and enhance our traditional offerings. These new solutions titled QuickStart and AwardFee are provided under our Performance Assurance service line. Revenues for fiscal 2005 were $1.2 million and $153,000 for QuickStart and AwardFee, respectively. We plan to continue providing these solutions and developing new solutions throughout fiscal 2006.

Results of Operations

We present the table below to show how the operating results have changed over the past three years. Next to each year s results of operations, we provide the relevant percentage of total revenues so that you can make comparisons about the relative change in revenues and expenses.

	Year Ended December 31,					
	As Restated 2005 (dollars in millions)		As Restated 2004 (dollars in millions)		2003 (dollars in millions)	
	$	%	$	%	$	%
Revenues:						
Competition management	$44.2	57.6%	$39.0	56.5%	$40.2	53.2%
Performance assurance	32.5	42.4	30.0	43.5	35.4	46.8
Total revenues	76.7	100.0	69.0	100.0	75.6	100.0
Cost of revenues	44.7	58.3	37.8	54.8	41.5	54.9
Gross profit	32.0	41.7	31.2	45.2	34.1	45.1
Selling, general and administrative expenses	21.6	28.1	16.9	24.5	14.4	19.0
Operating income	10.4	13.6	14.3	20.7	19.7	26.1
Interest income	0.6	0.8	0.2	0.2	0.1	0.1
Income taxes	3.9	5.1	5.1	7.3	6.5	8.6
Net income	$ 7.1	9.2%	$ 9.4	13.7%	$13.3	17.6%

Comparison of Fiscal Years Ended December 31, 2005, 2004 and 2003

Revenue. Revenue increased $7.7 million or 11.2% to $76.7 million in fiscal 2005, compared to $69.0 million for 2004. Through our sales and marketing efforts, we achieved a 5% growth in our traditional aerospace and defense markets and 31% is our non-aerospace and defense markets. As displayed above, revenues from our competition management and performance assurance service lines was 57.6% and 42.4%, respectively, as compared to 56.5% and 43.5% in 2004. We added 27 and 28 new customers in fiscal 2005 and 2004, respectively. Of the 27 and 28 new customers, they accounted for 8% and 9% of our total revenues in 2005 and 2004, respectively. Revenue from success fees decreased to $900,000 in 2005 as compared to $1.8 million in 2004. The timing and amounts recorded are dependent on award announcements and the mix of our business which utilizes this pricing model. During the second half of 2005 we experienced a significant reduction in services on a performance assurance project. The reduction resulted from a client who is experiencing budget pressure on one of their programs. This budget pressure continued throughout the quarter and will impact our ability to continue to service the client at the levels maintained during the first nine months of fiscal 2005.

Revenue decreased $6.6 million, or 8.8% to $69.0 million for fiscal 2004, compared to $75.6 million for the same period of the prior year. This decrease was caused by some of our existing programs under our performance assurance services which reached a level of maturation in which our services are coming to a conclusion. In addition, the decrease was due to delays by the federal government to issue planned requests-for-proposals (RFP), which affected our competition management revenue, and delays in the start up of some awarded programs, which affected our performance assurance revenues. These delays were caused by the funding required to fight the war on terror in Iraq and Afghanistan, election year uncertainties, and NASA s reprioritization. As displayed above, revenues from our competition management and performance assurance service lines was 56.5% and 43.5%, respectively, compared to 53.2% and 46.8% in 2003. We added 28 and 15 new customers for the years ended December 31, 2004 and 2003, respectively. Of the 28 and 15 new customers, they accounted for 9% and 3% of our total revenues in 2004 and 2003, respectively.

ITEM 7 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

Gross Margin. Gross margin increased $815,000, or 2.6% to $32.0 million for fiscal 2005 compared to $31.2 million for 2004. As a percentage of revenue, fiscal 2005 gross margin declined to 41.7% as compared to 45.2% in 2004. The decrease in gross margin as a percentage of revenue was due to two factors. First, in fiscal 2005 we made a planned change to our sales incentive compensation program which increased our cost of sales as a percentage of revenue by 200 basis points. We expect that our future gross margins will be consistent with current year. Second, in fiscal 2005 we received $900,000 in success fees compared to approximately $1.8 million in 2004. The timing and amounts recorded are dependent on award announcements and the mix of our business which utilizes this pricing model.

Gross margin decreased $2.9 million, or 8.4% to $31.2 million for fiscal 2004 compared to $34.1 million for 2003. The decrease in gross margin dollars was due to the decrease in revenue. As a percentage of revenue, gross margin of 45.2% was consistent with 45.1% for the same period of the prior year.

Selling, General and Administrative Expenses. Selling, general and administrative expenses consist principally of salary and benefit costs for our executives, sales and administrative personnel, professional services and other general corporate activities. Selling, general and administrative expenses in fiscal 2005 increased $4.7 million, or 27.7%, to $21.6 million, as compared to $16.9 million for the same period of the prior year. As a percentage of revenue, our selling, general and administrative expenses increased to 28.1% for fiscal 2005, compared to 24.5% for 2004. The $4.7 million increase was due to a $1.3 million increase in our sales and marketing expense related to the increase in hiring of our account executives, including their travel related expenses. In addition, we increased our internal training expenses by $600,000 for our employees delivering our services, and we incurred approximately $800,000 in expenses relating to an employee all hands offsite event held in 2005, but not in 2004. Lastly, in fiscal 2005, we recorded a non-cash stock-based compensation expense charge of $2.2 million related to the exercise of stock options, as required under accounting guidance EITF 00-23.

For fiscal 2004, selling, general and administrative expenses increased $2.6 million, or 17.9%, to $16.9 million as compared to $14.3 million for 2003. As a percentage of revenue, our selling, general and administrative expenses increased to 24.5% for the fiscal 2004, compared to 19.0% for 2003. The increase in expense was due to $2.7 million of expenses related to the continued increase in the hiring of our account executives, including their travel related expenses, related infrastructure support costs, and approximately $500,000 in expenses related to the implementation of Section 404 of the Sarbanes-Oxley Act. This increase of $3.2 million was offset by a $600,000 reduction in other professional fees, and $500,000 reduction in expenses relating to an employee all hands offsite event held in 2003, but not in 2004. Lastly, in fiscal 2005, we recorded a non-cash stock-based compensation expense charge of $424,000 related to the exercise of stock options, as required under accounting guidance EITF 00-23.

Operating Income. Operating income for fiscal 2005 decreased by $3.9 million, or 27.0%, to $10.4 million compared to $14.3 million for 2004. As a percentage of revenue for fiscal 2005, operating income decreased to 13.6% compared to 20.7% for 2004. The decrease in amount and as a percentage of revenue in fiscal 2005 was due to the increase in selling, general and administrative expenses as described above, offset by the increase in gross margin dollars.

For fiscal 2004, operating income decreased by $5.4 million, or 27.5%, to $14.3 million compared to 2003. As a percentage of revenue, operating income decreased to 20.7% for fiscal 2004 compared to 26.1% for 2003. The decrease in amount and as a percentage of revenue was due to the decrease in revenue and the increase in our selling, general and administrative expenses as described above.

Interest Income. Interest income in fiscal 2005 and 2004 increased by $394,000 and $119,000, or 63.0% and 50.0%, to $586,000 and $192,000, respectively. This increase is attributable to interest earned on our increased cash and cash equivalents and investment balances.

Income Tax Expense. Our effective income tax rate for fiscal 2005 was 35.8% compared to 34.9% in 2004. During 2005, the Company recorded a reduction of income tax expense of approximately $160,000, which related to the reduction of a federal income tax liability that was reversed due to the expiration of a statute of limitations.

Our effective income tax rate for fiscal 2004 was 34.9% compared to 33.0% for 2003. In 2004, the Company received a federal income tax refund related to the 1998 audit of one of our discontinued operations, which was higher than accrued for, which resulted in a benefit in the current year. The refund added approximately $0.02 per diluted share in 2004. In fiscal 2003, the Internal Revenue Service completed their examination for the calendar years 1998 through 2001. Based on the conclusion of the examination, we recorded a decrease in our tax contingency reserve leading to a reduction of income tax expense of $0.05 per diluted share.

ITEM 7 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

Liquidity and Capital Resources

A key element of the Company s cash flows for the last three years follows (in thousands):

	2005	2004	2003
Net cash provided by operating activities	$12.2	$ 8.3	$11.2
Net cash used in investing activities	(6.8)	(0.7)	(0.5)
Net cash (used in) provided by financing activities	(8.1)	(2.5)	2.2
Net cash used in discontinued operations	(0.3)	(0.6)	(1.1)
Net (decrease) increase in cash	$ (3.0)	$ 4.4	$11.8

Net increase in net cash provided by operating activities in fiscal 2005 as compared to 2004 and 2003 was due primarily to the income tax effect from the exercise of stock options of $1.9 million, $1.1 million and $600,000 in fiscal 2005, 2004, and 2003 respectively. In addition, we improved on our timing of our collection cycle which generated $2.8 million in fiscal 2005 compared to an outflow of cash of $1.0 million and $2.2 million in fiscal years 2004 and 2003, respectively. The increase in fiscal 2005 from the two factors stated above was offset by a decline in net earnings and the recording of prepaid income taxes of $924,000.

Net cash used in investing activities was $6.8 million in 2005, up from $718,000 from 2004 and $548,000 from 2003. Most of the decline in cash used in investing activities was a result of $5.0 million cash outflows from the purchase of short term investments in state issued debt securities. The remaining outflows in 2005 of $1.9 million was for $1.1 million to purchase and implement an Enterprise Resource Planning software program, $467,000 in leasehold improvements and furniture purchases related to the expansion of our office space, and general computer equipment purchases of $320,000. In fiscal 2006, we plan to use approximately $1.5 million to purchase and implement technology solutions that enhance our service offerings and the continued implementation of our Enterprise Resource Management software program.

Net cash used in financing activities was $8.1 million in fiscal 2005 compared to $2.5 million in 2004. Cash provided by financing activities in 2003 was $2.2 million. We received cash proceeds from the issuance of common stock of $2.0 million, $2.1 million and $2.2 million in fiscal 2005, 2004, and 2003, respectively. This increase was offset by cash outflows of $10.1 million and 4.6 million in fiscal 2005 and 2004 related to management s share repurchase program. No similar program existed in 2003.

In fiscal 2004, the Company s Board of Directors authorized a plan to repurchase up to $7.0 million of the Company s common stock. In fiscal 2005, the Company s Board of Directors authorized an increase of an additional $13.0 million, increasing the total authorization to repurchase the Company s common stock to $20.0 million. In January 2006, the Company s Board of Directors authorized an increase of an additional $10.0 million, increasing the total authorization to repurchase the Company s common stock to $30.0 million. The Company intends to repurchase shares from time to time, at prevailing prices, in the open market. The timing and amount of the share repurchases will be at the discretion of management and will be based on such factors as the stock price, general economic and market conditions, and other factors. The share repurchase plan may be suspended or discontinued at any time. Shares repurchased under the plan are cancelled. As of December 31, 2005, the Company has repurchased 1,813,166 shares at a total cost of $14.7 million.

Cash and cash equivalents plus short term investments increased $1.9 million during the year and were $24.1 million at the end of 2005. Based on projected cash flows from operations and existing credit facilities, management believes the Company has available sufficient liquidity to fund operations and capital requirements for at least the next twelve months.

The Company has a revolving credit agreement which allows for borrowings up to $10.0 million at the prime rate minus one half of one percent (-0.50%) per annum or LIBOR plus two and one quarter percent (2.25%) per annum.

The revolving credit agreement is renewable annually on April 30th of each year. Borrowings under the revolving credit agreement are unsecured. The agreement requires the Company to comply with certain financial covenants pertaining to its tangible net worth, ratio of total liabilities to tangible net worth, and ratio of current assets to current liabilities (as defined in the agreement). The agreement also contains certain negative covenants which, among other things, restrict the Company s ability to incur additional indebtedness of more than $1.0 million in excess of the $10.0 million limit set forth in the credit agreement and make capital expenditures in excess of $2.0 million without the prior written approval of the lender. At December 31, 2005, we had no outstanding borrowings under the line of credit, the bank had issued a letter of credit for $64,000 and we had $9.9 million in availability.

We believe we have sufficient working capital available under the line of credit and cash generated by continuing operations will be sufficient to fund operations for at least the next twelve months.

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ITEM 7 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

Contractual Obligations

Our contractual obligations are as follows at December 31, 2005:

Contractual Obligations Payments Due By Period (in thousands)	Total	1 Year or Less	1-3 Years	4-5 Years	After 5 Years
Operating leases	$ 6,812	$ 1,041	$ 2,120	$ 2,075	$ 1,576
Operating leases related to discontinued operations, net of Subleases	374	293	81		
Total	$ 7,186	$ 1,334	$ 2,201	$ 2,075	$ 1,576

Included in discontinued operations are three properties totaling approximately 56,000 square feet. All of the 56,000 square feet have been subleased under non-cancelable leases.

Off-Balance Sheet Arrangements

None.

Recently Issued Financial Accounting Standards

In December 2004, the FASB issued SFAS No. 123 (Revised 2004) Share Based Payment (SFAS 123R), which is a revision to SFAS 123 and supersedes APB 25 and SFAS 148. This statement requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. This statement establishes fair value as the measurement objective in accounting for share-based payment arrangements and requires all entities to apply a fair-value based measurement method in accounting for share-based payment transactions with employees except for equity instruments held by employee share ownership plans. SFAS 123R applies to all awards granted after the required effective date (the beginning of the first annual reporting period that begins after June 15, 2005) and to awards modified, repurchased, or cancelled after that date. As of the required effective date, all public entities that used the fair-value-based method for either recognition or disclosure under Statement 123 will apply this Statement using a modified version of prospective application. Under that transition method, compensation cost is recognized on or after the required effective date for the portion of outstanding awards, for which the requisite service has not yet been rendered, based on the grant-date fair value of those awards calculated under Statement 123 for either recognition or pro forma disclosures. For periods before the required effective date, those entities may elect to apply a modified version of the retrospective application under which financial statements for prior periods are adjusted on a basis consistent with the pro forma disclosures required for those periods by Statement 123. As a result, beginning in the first quarter of 2006, the Company will adopt SFAS 123R and begin reflecting the stock option expense determined under fair value based methods in its statement of operations rather than as pro-forma disclosure in the notes to the financial statements. The Company has not yet determined whether the adoption of SFAS 123R will result in amounts that are similar to the current pro forma disclosures under SFAS 123 and it is evaluating the requirements under SFAS 123R. Such adoption may have a substantial impact on its consolidated financial statements and earnings per share.

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ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Our primary objective in managing our cash balances is preservation of principal and maintenance of liquidity to meet our operating needs. Our excess cash balances are invested in money market accounts and short-term municipal bonds in which there is minimal interest rate risk.

ITEM 8 CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTAL DATA

Item 8 has been amended in this Form 10-K/A (i) to revise the financial statements as of and for the years ended December 31, 2005 and 2004 to record the stock compensation charges in conjunction with certain share repurchase transactions (ii) to add a note titled Restatement of Financial Statements , (iii) to add certain other explanatory disclosures regarding the restatement, (iv) to revise the report of the Company s independent registered public accounting firm on the Company s financial statements to reflect the restatement and (v) to update applicable cross references, but has not been otherwise updated or modified.

Our Consolidated Financial Statements are annexed to this Report as pages F-2 through F-16. An index to such materials appears on
page F-1.

ITEM 9 CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Management s report on internal control over financial reporting and the Company s independent registered public accounting firm s report thereon have each been amended in this Form 10-K/A to add reference to the restatement as an effect of the Company s material weakness in internal control over financial reporting related to review of complex accounting issues, but have not been otherwise updated or modified.

Disclosure Controls and Procedures

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by the Company is recorded, processed, summarized and reported, within the time periods specified in the rules and forms of the Securities and Exchange Commission (SEC). As of the end of the Company s fourth quarter, management conducted an evaluation (under the supervision and with the participation of the chief executive officer and the chief financial officer), pursuant to Rule 13a-15(b) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act), of the effectiveness of the Company s disclosure controls and procedures. As part of such evaluation, management considered the matters discussed below relating to internal control over financial reporting. Based on this evaluation, the Company s chief executive officer and chief financial officer have concluded that the Company s disclosure controls and procedures were not effective as of December 31, 2005, due to the material weakness in internal control over financial reporting described below.

Management s Report on Internal Control over Financial Reporting

The Company s management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) or 15d-15(f) under the Exchange Act.

Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer;

- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and

- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or

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disposition of the company s assets that could have a material effect on the financial statements.

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

Management (under the supervision and with the participation of the chief executive officer and the chief financial officer) has conducted an evaluation of its internal control over financial reporting based on the criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

The Company s management assessed the effectiveness of the Company s internal control over financial reporting as of December 31, 2005. One material weakness, as defined in standards established by the Public Company Accounting Oversight Board (United States), has been identified. A material weakness is a deficiency in internal control over financial reporting that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following is a description of the one material weakness in the Company s internal control over financial reporting:

Review of Complex Accounting Issues There are inadequate levels of review of complex accounting issues. Audit adjustments were needed to correct errors resulting from this internal control deficiency, which manifested itself in the failure to record non-cash stock compensation expenses. These adjustments are reflected in the Company s audited financial statements for the years ended December 31, 2005 and 2004.

To address this material weakness, the Company implemented the following remediation plans:

The Company implemented increased levels of review of complex accounting issues.

The Company implemented a new policy and guidelines for increased, individualized professional development for finance and accounting personnel

Because of the material weakness described above, management has concluded that, as of December 31, 2005, the Company did not maintain effective internal control over financial reporting.

Ernst & Young LLP, the independent registered public accounting firm that audited the Company s financial statements included in the Form 10-K/A Amendment No. 1, has issued an attestation report on management s assessment of the effectiveness of internal control over financial reporting as of December 31, 2005, which is included below.

Changes in Internal Control

No change in internal control over financial reporting was made in the fourth quarter of 2005 that materially affected, or is likely to materially affect, the Company s internal control over financial reporting.

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Attestation Report of Independent Registered Public Accounting Firm
Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting
To the Board of Directors and Shareholders of SM&A

We have audited management s assessment, included in the accompanying Management s Report on Internal Control Over Financial Reporting, appearing in Item 9A of this Amended Annual Report on Form 10-K/A, that SM&A did not maintain effective internal control over financial reporting as of December 31, 2005, because of the effect of a material weakness identified in management s assessment, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). SM&A s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the Company s internal control over financial reporting based on our audit.

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

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

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

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weakness has been identified and included in management s assessment.

During the first quarter of 2006, the Company became aware of the need to restate its consolidated financial statements for the years ended December 31, 2005 and 2004 due to inadequate levels of review of complex accounting issues, resulting in additional stock compensation charges. These stock compensation charges impacted the Company s Selling, general and administrative expenses, Income tax expense, Common stock, and Accumulated deficit accounts and related financial statement disclosures. The expenses associated with these share repurchase transactions has been recorded in this Amended Annual Report on Form 10-K/A.

This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2005 financial statements and this report does not affect our report dated February 20, 2006 except for Note 1, Restatement of Financial Statements, as to which the date is May 11, 2006, on those financial statements.

In our opinion, management s assessment that SM&A did not maintain effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the COSO control criteria. Also, in our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, SM&A did not maintained effective internal control over financial reporting as of December 31, 2005 based on the COSO control criteria.

We do not express an opinion or any other form of assurance on management s statements referring to plans for corrective action and remediation of the material weakness identified in management s assessment.

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/s/ Ernst & Young LLP

Orange County, California
February 20, 2006 (except for the effects of the
material weakness described in the sixth paragraph above,
as to which the date is May 11, 2006.)

Item 9B Other Information

None.

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PART IV

ITEM 15 EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) Documents filed as part of this report:

(1) Index to Consolidated Financial Statements

(2) Financial Statement Schedules

All other financial statement schedules have been omitted because they are not applicable, not required, or the information is included in the Consolidated Financial Statements or notes thereto.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders
SM&A

We have audited the accompanying consolidated balance sheets of SM&A as of December 31, 2005 and 2004, and the related consolidated statements of income, shareholders equity, and cash flows for each of the three years in the period ended December 31, 2005. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of SM&A at December 31, 2005 and 2004, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As described in Note 1, Restatement of Financial Statements, the Company has restated it consolidated financial statements for each of the two years in the period ended December 31, 2005.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of SM&A s internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated February 20, 2006 (except for the effects of the material weakness described in the sixth paragraph of that report, as to which the date is May 11, 2006), expressed an unqualified opinion on management s assessment of and an adverse opinion on the effectiveness of internal control over financial reporting.

/s/ ERNST & YOUNG LLP

Orange County, California
February 20, 2006
(except for Note 1 Restatement of Financial Statements,
as to which the date is
May 11, 2006)

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SM&A
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	December 31, As Restated 2005	December 31, As Restated 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 19,103	$ 22,148
Investments	4,950	
Accounts receivable, net of allowance of $200	10,435	13,198
Prepaid expenses and other current assets	380	252
Prepaid income taxes	924	
Deferred income taxes	319	539
Total current assets	36,111	36,137
Fixed assets, net	2,571	1,037
Other assets	60	209
	$ 38,742	$ 37,383
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 762	$ 1,192
Accrued compensation and related benefits	2,129	1,793
Income taxes payable		565
Net liabilities of discontinued operations	396	727
Total current liabilities	3,287	4,277
Deferred income taxes	56	242
Other liabilities	539	173
Total liabilities	3,882	4,692
Commitments and contingencies		
Shareholders equity:		
Preferred stock: Authorized 10,000,000 shares. None issued and outstanding		
Common stock, no par value: Authorized 50,000,000 shares. Issued and outstanding 19,818,443 and 20,218,342, respectively	46,126	51,038
Accumulated deficit	(11,266)	(18,347)
Total shareholders equity	34,860	32,691
	$ 38,742	$ 37,383

See accompanying notes to consolidated financial statements.

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SM&A
CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share data)

	Years Ended December 31,		
	As Restated 2005	As Restated 2004	2003
Revenue	$ 76,711	$ 68,954	$ 75,593
Cost of revenue	44,703	37,761	41,533
Gross margin	32,008	31,193	34,060
Selling, general and administrative expenses	21,572	16,895	14,329
Operating income	10,436	14,298	19,731
Interest income	586	192	73
Income before income taxes	11,022	14,490	19,804
Income tax expense	3,941	5,055	6,536
Net income	$ 7,081	$ 9,435	$ 13,268
Net income per share:			
Basic	$ 0.35	$ 0.46	$ 0.66
Diluted	$ 0.34	$ 0.44	$ 0.62
Shares used in calculating net income per share:			
Basic	20,271	20,428	19,991
Diluted	20,797	21,521	21,428

See accompanying notes to consolidated financial statements.

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SM&A
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
(in thousands)

	Common Stock Shares Outstanding	Common Stock Amount	Accumulated Deficit	Total Shareholders Equity
Balances at December 31, 2002	19,701	$ 49,438	$ (41,050)	$ 8,388
Net income and comprehensive income			13,268	13,268
Shares issued upon exercise of options	535	1,696		1,696
Income tax effect from exercise of stock options		571		571
Shares issued for employee stock purchase plan	100	510		510
Balances at December 31, 2003	20,336	$ 52,215	$ (27,782)	$ 24,433
Net income and comprehensive income (as restated)			9,435	9,435
Shares purchased under repurchase program	(626)	(4,623)		(4,623)
Shares issued upon exercise of options	419	1,355		1,355
Compensation expense associated with stock options, net of taxes (as restated)		257		257
Income tax effect from exercise of stock options		1,088		1,088
Shares issued for employee stock purchase plan	89	746		746
Balances at December 31, 2004 (as restated)	20,218	$ 51,038	$ (18,347)	$ 32,691
Net income and comprehensive income (as restated)			7,081	7,081
Shares purchased under repurchase program	(1,188)	(10,060)		(10,060)
Shares issued upon exercise of options	711	1,365		1,365
Compensation expense associated with stock options, net of taxes (as restated)		1,346		1,346
Income tax effect from exercise of stock options		1,846		1,846
Shares issued for employee stock purchase plan	77	591		591
Balances at December 31, 2005 (as restated)	19,818	$ 46,126	$ (11,266)	$ 34,860

See accompanying notes to consolidated financial statements.

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SM&A
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Years Ended December 31, As Restated 2005	As Restated 2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 7,081	$ 9,435	$ 13,268
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	570	368	274
Stock based compensation expense, net of taxes	1,346	257	
Loss (gain) on disposal of fixed assets		36	(35)
Deferred income taxes	34	410	497
Income tax effect from exercise of stock options	1,846	1,088	571
Changes in operating assets and liabilities:			
Accounts receivable	2,763	(1,020)	(2,217)
Prepaid income taxes	(924)		
Prepaid expense and other assets	21	(23)	98
Accounts payable	(430)	509	(486)
Accrued compensation and related benefits	336	(1,844)	805
Income taxes payable	(565)	(875)	(1,549)
Other liabilities	145	(33)	(34)
Net cash provided by operating activities	12,223	8,308	11,192
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of investments	(4,950)		
Purchases of fixed assets	(1,883)	(718)	(548)
Net cash used in investing activities	(6,833)	(718)	(548)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of common stock	1,956	2,101	2,206
Payment for repurchase of shares	(10,060)	(4,623)	
Net cash (used in) provided by financing activities	(8,104)	(2,522)	2,206
Net (decrease) increase in cash from continued operations	(2,714)	5,068	12,850
Net cash used in discontinued operations by operating activities	(331)	(632)	(1,094)
Net (decrease) increase in cash	(3,045)	4,436	11,756
Cash and cash equivalents at beginning of year	22,148	17,712	5,956

Cash and cash equivalents at end of year	$ 19,103	$ 22,148	$ 17,712
SUPPLEMENTAL INFORMATION CASH PAID FOR:			
Interest	$	$	$ 21
Income taxes	$ 4,436	$ 5,222	$ 7,770
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING ACTIVITIES:			
Tenant leasehold improvement incentive	$ 255		
Accumulated amortization of tenant leasehold improvement	(34)		
	$ 221		

See accompanying notes to consolidated financial statements.

SM&A
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the Years Ended December 31, 2005, 2004, and 2003

As used herein, SM&A, Company, its, and similar terms include SM&A and subsidiaries, unless the context indicates otherwise.

Note 1. Restatement of Financial Statements

The Company s financial statements for the years ended December 31, 2005 and 2004 have been restated to reflect a non-cash charge of $1.3 million and $257,000, net of taxes, respectively, on its consolidated statements of operations for additional compensation expense resulting from the accounting for certain share repurchase transactions.

Note 2. Description of Business and Summary of Significant Accounting Policies

Description of Business. SM&A is a consulting firm who is a provider of competition management and high-value performance assurance services. Under these two service lines, our approximately 300 employees and consultants provide strategy, proposal management, program management, systems engineering, expert support, program planning, and other high-value technical support to major industrial customers in the defense, homeland security, aerospace, information technology, architect and engineering sectors. The Company operates in one business segment and conducts substantially all of its business in the United States.

Principles of Consolidation. The consolidated financial statements include accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates. The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Estimates made in preparing the financial statements include the allowance for doubtful accounts, reserves for discontinued operations, and income tax valuation allowances.

Cash and Cash Equivalents. The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents.

Investments. Securities investments that the Company has the positive intent and ability to hold to maturity are classified as held-to-maturity securities. Investments held to maturity mature between one and twelve months and are reported at amortized cost.

Revenue Recognition. The Company recognizes revenue from services rendered when the following four revenue recognition criteria are met: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the selling price is fixed or determinable, and collectibility is reasonably assured. The majority of the Company s services are provided under time and expenses billing arrangements and revenue is recognized on the basis of hours utilized, and other reimbursable contract costs incurred during the period. Revenue is directly related to the total number of hours billed to clients and the associated hourly billing rates. A limited amount of revenue is also derived from success fees offered to clients as a pricing option, and recorded as revenue only upon the attainment of the specified incentive criteria. Success fees are not billable and revenue is not recorded until the customer wins a contract.

Concentrations of Credit Risk and Major Customers. Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of accounts receivable. The Company s accounts receivable are derived from revenue earned from customers primarily in the United States. The majority of the Company s receivables are from large companies in the aerospace and defense industries. The Company controls credit risk through credit approvals and monitoring procedures and, generally, does not require collateral or other security to support financial instruments subject to credit risk. Management must make estimates regarding the collection of its accounts receivable. Management specifically analyzes accounts receivable and analyzes historical bad debts, customer concentrations, customer credit-worthiness, current economic trends, and changes in its customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. Credit losses have historically been within management s expectations.

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SM&A

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2. Description of Business and Summary of Significant Accounting Policies (continued)

Customers representing more than 10% of the Company s revenue and accounts receivable are as follows:

	Revenue			Accounts Receivable at December 31,
	Years Ended December 31,			
	2005	2004	2003	2005
The Boeing Company	27.4%	30.1%	26.1%	22.1%
Accenture LTD	20.5	15.7	15.0	29.8
Lockheed Martin Corporation	14.6	22.7	36.0	9.1
Total	62.5%	68.5%	77.1%	61.0%

Fair Value of Financial Instruments. The carrying value of cash and cash equivalents, accounts receivable, payables, and accrued liabilities are measured at cost and approximate their respective fair values because of the short maturities of these instruments.

Long-Lived Assets. Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. The Company does not perform a periodic assessment of assets for impairment in the absence of such information or indicators. Conditions that would necessitate an impairment assessment include a significant decline in the observable market value of an asset, a significant change in the extent or manner in which an asset is used, or a significant adverse change that would indicate that the carrying amount of an asset or group of assets is not recoverable. For long-lived assets to be held and used, the Company measures fair value based on quoted market prices or based on discounted estimates of future cash flows. Long-lived assets to be disposed of are carried at fair value less costs of sale.

Fixed Assets. Fixed assets are stated at cost less accumulated depreciation, and are depreciated on a straight-line basis over the estimated useful lives of the assets, generally three to five years. Leasehold improvements are being amortized over the shorter of the useful life or lease term.

Marketing and Advertising Expense. Marketing expenses consist of advertising, promotional and public relations expenditures. The Company expenses general media advertising costs as incurred. Advertising expense and other promotional costs are $435,000, $406,000 and $337,000 in 2005, 2004, and 2003, respectively. At December 31, 2005, there was $10,000 of advertising costs included in prepaid expenses. There are no prepaid advertising costs included in prepaid expenses and other current assets at December 31, 2004.

Stock-Based Compensation. The Company has elected to follow Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, to account for options to purchase common stock of the Company issued pursuant to the Company s stock-based compensation plans. Under APB Opinion No. 25, no compensation cost is recognized because the exercise price of options granted under the Company s stock-based compensation plans is at least equal to at least the market price of the underlying stock on the date of grant. Had compensation costs for these plans been determined at the grant dates for awards under the alternative accounting method provided for in SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure an amendment to FASB Statement No. 123, net income and earnings per share, on a pro forma basis, would have been (in thousands except for per share information):

	Years Ended December 31,		
	As Restated	As Restated	

	2005	2004	2003
Net income as reported	$ 7,081	$ 9,435	$ 13,268
Stock based compensation expense, net of taxes	1,346	257	
Pro forma compensation expense, net of taxes	(1,923)	(928)	(383)
Net income SFAS No. 123 pro forma	$ 6,504	$ 8,764	$ 12,885
Basic income per share as reported	$ 0.35	$ 0.46	$ 0.66
Pro forma compensation expense, net of taxes	(0.03)	(0.03)	(0.02)
Basic income per share SFAS No. 123 pro forma	$ 0.32	$ 0.43	$ 0.64

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	Years Ended December 31,		
	As Restated 2005	As Restated 2004	2003
Diluted income per share as reported	$ 0.34	$ 0.44	$ 0.62
Pro forma compensation expense, net of taxes	(0.03)	(0.03)	(0.02)
Diluted income per share SFAS No. 123 pro forma	$ 0.31	$ 0.41	$ 0.60

SM&A
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2. Description of Business and Summary of Significant Accounting Policies (continued)

The fair value for each option granted was estimated at the date of grant using a Black-Scholes option-pricing model, assuming no expected dividends and the following weighted average assumptions:

	2005	2004	2003
Stock volatility	84.12%	91.14%	99.41%
Risk-free interest rate	4.37%	3.28%	2.99%
Option term in years	2.99	3.19	3.35
Stock dividend yield	N/A	N/A	N/A

On June 8, 2005, the Board of Directors (the Board) of SM&A (the Company), upon recommendation of the Board s Audit and Compensation Committees, approved the accelerated vesting of certain unvested and out-of-the-money options held by current employees, officers and directors (the Acceleration). The options accelerated were granted under the Company s Second Amended and Restated Equity Incentive Plan (the Plan).

As a result of the Acceleration, the affected unvested options are those that had exercise prices of greater than $8.87 per share. The closing sales price of the Company s common stock on the NASDAQ National market on June 8, 2005, the effective date of the Acceleration, was $8.87. Pursuant to the Acceleration, options granted under the Plan to purchase approximately 403,000 shares of the Company s common stock that would otherwise have vested at various times within the next four years became fully vested. Of the 403,000 options, 200,000 options were granted to current Directors, 100,000 were granted to current Officers, and the remaining 103,000 options were granted to current employees. The options have a range of exercise prices of $9.07 to $12.66. As a result of the Board s decision to approve the Acceleration, each agreement for options subject to the Acceleration is deemed to be amended to reflect the Acceleration as of the effective date, but all other terms and conditions of each such option agreement remain in full force and effect.

The decision to initiate the Acceleration under the Plan, which the Company believes to be in the best interest of the Company and its shareholders, was made primarily to reduce compensation expense that would be expected to be recorded in future periods following the Company s adoption of Financial Accounting Standards Board (FASB) Statement No. 123, Share-Based Payment (revised 2004) (SFAS 123R). The Company currently accounts for stock-based compensation using the provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees. The SFAS 123R will require the Company to record compensation expense equal to the fair value of all equity-based compensation over the vesting period of each such award. As a result of the Acceleration under the Plan, the Company expects to reduce its aggregate compensation expense related to the accelerated options by a total of approximately $1.8 million before taxes over the next four years (the remaining vesting period for the accelerated options). This estimate is subject to change, but is based on approximated value calculations using the Black-Scholes methodology.

Income Taxes. The Company recognizes deferred tax assets and liabilities based on differences between the financial reporting and tax bases of assets and liabilities using the enacted tax rates. The Company provides a valuation allowance when it is more likely than not that some of the deferred tax assets will not be realized.

Net Income Per Share. Basic net income per share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the periods presented. Diluted net income per share is computed by dividing net income available to common shareholders by the weighted average number of common and common equivalent shares outstanding during the periods presented, assuming the exercise of all in-the-money stock options. Common stock equivalent shares have not been included where inclusion would be anti-dilutive.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2. Description of Business and Summary of Significant Accounting Policies (continued)

The following table illustrates the number of shares used in the computation of basic and diluted net income per share (in thousands):

	2005	2004	2003
Denominator for basic income per common share-weighted average shares	20,271	20,428	19,991
Incremental common shares attributable to dilutive outstanding stock options	526	1,093	1,437
Denominator for diluted income per common share	20,797	21,521	21,428

Anti-dilutive shares excluded from the foregoing reconciliation are 544,690, 525,660 and 39,862 for 2005, 2004 and 2003, respectively.

Comprehensive Income. Statement of Financial Accounting Standards No. 130, Reporting Comprehensive Income (SFAS 130), establishes standards for reporting and display of comprehensive income, its components and accumulated balances. Comprehensive income is defined to include all changes in equity except those resulting from investments by owners and distributions to owners. Among other disclosures, SFAS 130 requires that all items that are required to be recognized under current accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. In addition to net income, comprehensive income (loss) includes all changes in equity during a period, except those resulting from investments by and distributions to owners. Items of comprehensive income include foreign currency exchanges and unrealized gains and losses on investments classified as available for sale. For the years ended December 31, 2005, 2004 and 2003, comprehensive income equaled net income.

Recent Accounting Pronouncements. In December 2004, the FASB issued SFAS No. 123 (Revised 2004) Share Based Payment (SFAS 123R), which is a revision to SFAS 123 and supersedes APB 25 and SFAS 148. This statement requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. This statement establishes fair value as the measurement objective in accounting for share-based payment arrangements and requires all entities to apply a fair-value based measurement method in accounting for share-based payment transactions with employees except for equity instruments held by employee share ownership plans. SFAS 123R applies to all awards granted after the required effective date (the beginning of the first annual reporting period that begins after June 15, 2005) and to awards modified, repurchased, or cancelled after that date. As of the required effective date, all public entities that used the fair-value-based method for either recognition or disclosure under Statement 123 will apply this Statement using a modified version of prospective application. Under that transition method, compensation cost is recognized on or after the required effective date for the portion of outstanding awards, for which the requisite service has not yet been rendered, based on the grant-date fair value of those awards calculated under Statement 123 for either recognition or pro forma disclosures. For periods before the required effective date, those entities may elect to apply a modified version of the retrospective application under which financial statements for prior periods are adjusted on a basis consistent with the pro forma disclosures required for those periods by Statement 123. As a result, beginning in the first quarter of 2006, the Company will adopt SFAS 123R and begin reflecting the stock option expense determined under fair value based methods in its statement of operations rather than as pro-forma disclosure in the notes to the financial statements. The Company has not yet determined whether the adoption of SFAS 123R will result in amounts that are similar to the current pro forma disclosures under SFAS 123 and it is evaluating the requirements under SFAS 123R. Such adoption may have a substantial impact on its consolidated financial statements and earnings per share.

Note 3. Fixed Assets

A summary of fixed assets follows at December 31 (in thousands):

	2005	2004
Computer equipment	$ 1,835	$ 1,514
ERP System	1,095	
Furniture and equipment	389	156
Leasehold improvements	711	222
	4,030	1,892
Less accumulated depreciation and amortization	(1,459)	(855)
	$ 2,571	$ 1,037

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 3. Fixed Assets (continued)

In January 2005, the Company capitalized tenant improvement incentives of $255,000, which is included in leasehold improvements. Amortization expense for this addition was $34,000 in 2005.

Depreciation expense was $604,000, $368,000 and $274,000 in 2005, 2004 and 2003, respectively, of which $64,000, $43,000 and $19,000 are included in cost of sales, and $540,000, $325,000 and $255,000 are included in selling, general and administrative expenses for the years ended December 31, 2005, 2004, and 2003, respectively.

Note 4. Related Party Transactions (restated)

The Company periodically leases aircraft from SummitJets, Inc., which is owned by the Company s Chairman and Chief Executive Officer. The lease rate was determined through a review of prevailing market rates for such services. During the years ended December 31, 2005, 2004 and 2003, the Company recorded an expense of $121,000, $139,000 and $49,000, respectively. The expense is included in selling, general and administrative expenses. Of the $121,000 expensed in 2005, no balance remained in accounts payable as of December 31, 2005.

In March 2005, the Company facilitated the exercising of stock options upon the retirement of a former member of the Board of Directors. Upon the exercising of the options, the Company repurchased 15,000 shares for a total discounted cost of $117,000. In April 2005, the Company facilitated the exercising of stock options upon the retirement of a former member of the Board of Directors. Upon the exercising of the options, the Company repurchased 200,000 shares for a total discounted cost of $1.7 million. In April 2005, the Company facilitated the exercising of stock options upon the resignation of the former President and Chief Operating Officer. Upon the exercising of the options, the Company repurchased 150,625 shares for a total discounted cost of $1.2 million. The Company purchased all the shares at a 3.6% discount. The Company recorded $2.2 million of stock compensation expenses for these transactions as a result of guidance in Emerging Issues Task Force No. 00-23, *Issues Related to the Accounting for Stock Compensation under APB Opinion No. 25 and FASB Interpretation No. 44* (EITF 00-23).

During 2004, the Company facilitated the exercising of stock options upon the retirement of a former member of the Board of Directors. Upon the exercising of the options, the Company repurchased 87,500 shares for a total discounted cost of $595,000. The Company recorded $424,000 of stock compensation expense for this transaction as a result of guidance in EITF 00-23.

Two officers of the Company serve on the Board of Directors of two not-for-profit agencies. The Company has provided charitable donations to these two not-for-profit agencies in the amount of $18,000 and $28,000 in 2005 and 2004, respectively. No donations to these not-for-profit agencies were made in 2003.

Note 5. Investments in Marketable Securities

During 2005, the Company purchased short-term state issued securities for $5.0 million. As of December 31, 2005, our short-term state issued debt securities amortized cost was $5.0 million and interest income was approximately $20,000. There were no realized or unrealized gains or losses at December 31, 2005.

Note 6. Revolving Line of Credit

The Company has a revolving credit agreement which allows for borrowings up to $10.0 million at the prime rate minus one half of one percent (-0.50%) per annum or LIBOR plus two and one quarter percent (2.25%) per annum. The revolving credit agreement is renewable annually on April 30th of each year. Borrowings under the revolving credit agreement are unsecured. The agreement requires the Company to comply with certain financial covenants pertaining to its tangible net worth, ratio of total liabilities to tangible net worth, and ratio of current assets to current liabilities (as defined in the agreement). The agreement also contains certain negative covenants which, among other things, restrict the Company s ability to incur additional indebtedness of more than $1.0 million in excess of the $10.0 million limit set forth in the credit agreement and make capital expenditures in excess of $2.0 million without the prior written approval of the lender. At December 31, 2005, we had no outstanding borrowings under the line of credit, the bank had issued a letter of credit for $64,000 and we had $9.9 million in availability.

Note 7. Discontinued Operations

Prior to fiscal year 2003, the Company sold and dissolved two of its business segments. The balance owed at December 31, 2005 of $396,000 principally represents the remaining office lease commitments, net of subleases, over the remaining terms of the leases. During the years ended December 31, 2005 and 2004, the Company paid $331,000 and $632,000 net of sublease receipts, respectively, related to the leased property.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 8. Income Taxes

Significant components of income tax expense attributable to income from continuing operations consists of (in thousands):

	Current	Deferred	Total
Year ended December 31, 2005:			
Federal	$ 3,061	$ 32	$ 3,093
State	846	2	848
	$ 3,907	$ 34	$ 3,941
Year ended December 31, 2004:			
Federal	$ 4,180	$ 337	$ 4,517
State	465	73	538
	$ 4,645	$ 410	$ 5,055
Year ended December 31, 2003:			
Federal	$ 4,379	$ 381	$ 4,760
State	1,661	115	1,776
	$ 6,040	$ 496	$ 6,536

The following is a reconciliation of the statutory federal income tax rate to the Company s effective tax rate:

	2005	2004	2003
Income taxes at statutory federal rates	35.0%	35.0%	35.0%
State taxes, net of federal income tax benefit	3.1	2.3	5.8
Reduction of tax liabilities based on tax examination effects	(2.4)	(3.6)	(7.8)
Other rate changes	0.1	1.2	
	35.8%	34.9%	33.0%

Significant components of deferred tax assets and liabilities are as follows (in thousands):

	2005	2004
Deferred tax assets:		
Accrued expenses	$ 40	$ 120
Allowance for doubtful accounts	91	91
Capital loss carryover	1,537	1,537
Discontinued operations accrual	188	328
Total deferred tax assets before valuation allowance	1,856	2,076
Valuation allowance	(1,537)	(1,537)

Total deferred tax assets	319	539
Deferred tax liabilities:		
Prepaid expenses	(39)	(79)
Depreciation	(6)	(126)
Other	(11)	(37)
Total deferred tax liabilities	(56)	(242)
Net deferred tax assets	$ 263	$ 297

In assessing the viability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes that it is more likely than not the Company will realize the benefits of these deductible differences. The amount of deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income are reduced.

SM&A
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 8. Income Taxes (continued)

During 2004, the Company received a federal income tax refund related to the 1998 IRS audit of one of its discontinued operations, which was higher than previously accrued for. During 2003, the Internal Revenue Service completed their examination related to the years 1998 through 2001. Based on the favorable conclusion of their examination, the Company recorded a reduction in its tax contingency of $1.5 million.

During 2004, the Company completed and filed its federal and state income tax returns for the calendar year ended December 31, 2003. Based on the income tax returns filed, the Company recorded an adjustment to its state effective tax rate in the second quarter resulting in a reduction of income tax expense of $182,000. This reduction of $182,000, coupled with a current year state tax provision rate adjustment of $125,000, resulted in a reduction of income tax expense of approximately $307,000.

During 2005, the Company recorded a reduction of income tax expense of approximately $160,000, which related to the reduction of a federal income tax liability that was reversed due to the expiration of a statute of limitations.

At December 31, 2005, the Company had a capital loss carryover of approximately $3.5 million that expires in 2006. The Company has recorded a full valuation allowance against this deferred tax asset since the Company does not anticipate that it will have sufficient capital gains to utilize the carryover before it expires.

Note 9. Stock-Based Compensation and Employee Benefit Plans

Stock Option Plan. In 1997, the Company adopted the 1997 Stock Option Plan, later amended and restated (the Option Plan), under which incentive and non-statutory stock options to acquire shares of the Company s common stock may be granted to officers, employees, and consultants. The Option Plan is administered by the Board of Directors and permits the issuance of up to 4,000,000 shares of the Company s common stock. Incentive stock options must be issued at an exercise price not less than the fair market value of the underlying shares on the date of grant. Options granted under the Option Plan vest over various terms up to ten years and are exercisable over a period of time, not to exceed ten years, and are subject to other terms and conditions specified in each individual employee option agreement. A summary of employee stock options is as follows:

	Number of Options	Weighted Average Exercise Price	Weighted Average Fair Value of Options Granted	Options Exercisable
Outstanding as of December 31, 2002	2,759,220	$ 4.20		1,328,552
Granted	277,250	7.09	$ 4.64	
Exercised	(534,814)	3.17		
Canceled	(610,514)	9.84		
Outstanding as of December 31, 2003	1,891,142	$ 3.10		847,628
Granted	753,500	9.71	$ 5.88	
Exercised	(424,652)	3.21		
Canceled	(172,569)	4.07		
Outstanding as of December 31, 2004	2,047,421	$ 5.43		878,438
Granted	533,000	8.37	$ 5.00	
Exercised	(705,467)	1.93		
Canceled	(336,056)	7.66		
Outstanding as of December 31, 2005	1,538,898	$ 7.56		913,872

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 9. Stock-Based Compensation and Employee Benefit Plans (continued)

The following table summarizes information concerning stock options outstanding at December 31, 2005:

Range of Exercise Prices	Number of Options Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number of Options Exercisable	Weighted Average Exercise Price
\$0.0000 - 2.8625	132,973	5.3	1.48	125,723	1.42
\$2.8626 - 5.7250	240,075	6.5	3.29	165,049	3.23
\$5.7251 - 8.5875	584,250	8.9	8.02	90,500	7.94
\$8.5876 - 11.4500	388,600	8.2	9.52	339,600	9.63
\$11.4501 - 14.3125	193,000	7.5	11.75	193,000	11.75
	1,538,898	7.9	7.56	913,872	7.63

Employee Stock Purchase Plan. In 1999, the Company adopted an Employee Stock Purchase Plan, later amended and restated (the ESPP). Under the ESPP, shares of the Company s common stock may be purchased at three-month intervals at 95% of the lower of the fair market value on the first or the last day of each three-month period. Employees may elect to have a maximum of 15% of their gross bi-weekly compensation withheld during any offering period. The total authorized shares currently allocated to the ESPP reserve are 1,400,000 and as of December 31, 2005, 1,255,426 shares have been distributed to participants.

Defined Contribution Plans. The SM&A 401(k) Plan and Trust (the Plan) is a defined contribution plan. The Plan includes a tax-deferred 401(k) provision and applies to all employees. Contributions are made to the Plan by employees and the Company. The Plan permits employee contributions up to 20% of eligible compensation with Company matching, supplemental contributions for certain classes of employees based on performance criteria, and profit sharing under certain conditions. The Company s matching contribution was \$318,000, \$360,000 and \$121,000 for the years ended December 31, 2005, 2004, and 2003.

Shares Reserved for Future Issuance. At December 31, 2005, the Company had reserved 1,875,994 shares for future issuance under the stock option plan and 144,574 shares under the employee stock purchase plan.

Note 10. Stockholders Equity

In May 2004, the Company s Board of Directors authorized a plan to repurchase up to \$7.0 million of the Company s common stock. In April and October 2005, the Company s Board of Directors authorized an increase of an additional \$5.0 million and \$8.0 million, respectively, increasing the total authorization to repurchase the Company s common stock to \$20.0 million. In January 2006, the Company s Board of Directors authorized an increase of an additional \$10.0 million increasing the total authorization to repurchase the Company s common stock to \$30.0 million. The Company intends to repurchase shares from time to time, at prevailing prices, in the open market. The timing and amount of the share repurchases will be at the discretion of management and will be based on such factors as the stock price, general economic and market conditions, and other factors. The share repurchase plan may be suspended or discontinued at any time. Shares repurchased under the plan are cancelled. As of December 31, 2005, the Company had repurchased 1,813,166 shares at a total cost of \$14.7 million.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 11. Commitments and Contingencies

Leases. The Company currently leases office facilities and property and equipment under non-cancelable operating leases, which include escalation clauses. Rental expense under operating lease agreements relating to continuing operations for 2005, 2004, and 2003 was $1,325,000, $725,000 and $685,000, respectively. The aggregate future minimum rental to be received under non-cancelable subleases relating to discontinued operations as of December 31, 2005 was $1.4 million. Future minimum lease payments are as follows for the years ending December 31 (in thousands):

	Continuing Operations	Discontinued Operations, net of subleases
2006	$ 1,041,000	$ 293,000
2007	1,068,000	81,000
2008	1,052,000	
2009	1,048,000	
2010	1,027,000	
Thereafter	1,576,000	
Total	$ 6,812,000	$ 374,000

Contingencies. From time to time, the Company may be involved in legal proceedings and claims that arise in the ordinary course of business. The Company is currently unaware of any legal proceedings or claims against it that management believes will have, individually or in the aggregate, a materially adverse effect on its business, financial condition, or operating results.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 12. Quarterly Financial Data (Unaudited)

The following summarized unaudited quarterly financial data has been prepared using the Company s consolidated financial statements (in thousands, except per share data):

2005 (As Restated)	First Quarter	Second Quarter	Third Quarter	Forth Quarter	Total
Revenue	$20,245	$20,261	$19,678	$16,527	$76,711
Gross margin	$ 8,722	$ 8,678	$ 8,207	$ 6,401	$32,008
Net income	$ 2,537	$ 1,190	$ 2,558	$ 796	$ 7,081
Net income per share basic	$ 0.13	$ 0.06	$ 0.13	$ 0.04	$ 0.35
Net income per share diluted	$ 0.12	$ 0.06	$ 0.12	$ 0.04	$ 0.34
Shares used in calculating net income per share:					
Basic	20,263	20,370	20,432	20,020	20,271
Diluted	21,085	20,879	20,870	20,365	20,797

2005 (As Previously Reported)	First Quarter	Second Quarter	Third Quarter	Forth Quarter	Total
Revenue	$20,245	$20,261	$19,678	$16,527	$76,711
Gross margin	$ 8,722	$ 8,678	$ 8,207	$ 6,401	$32,008
Net income	$ 2,596	$ 2,477	$ 2,558	$ 796	$ 8,427
Net income per share basic	$ 0.13	$ 0.12	$ 0.13	$ 0.04	$ 0.42
Net income per share diluted	$ 0.12	$ 0.12	$ 0.12	$ 0.04	$ 0.41
Shares used in calculating net income per share:					
Basic	20,263	20,370	20,432	20,020	20,271
Diluted	21,085	20,879	20,870	20,365	20,797

2004 (As Restated)	First Quarter	Second Quarter	Third Quarter	Forth Quarter	Total
Revenue	$18,487	$16,159	$16,078	$18,230	$68,954
Gross margin	$ 8,343	$ 7,489	$ 7,075	$ 8,286	$31,193
Net income	$ 2,940	$ 2,283	$ 1,667	$ 2,545	$ 9,435
Net income per share basic	$ 0.14	$ 0.11	$ 0.08	$ 0.13	$ 0.46
Net income per share diluted	$ 0.14	$ 0.11	$ 0.08	$ 0.12	$ 0.44
Shares used in calculating net income per share:					
Basic	20,409	20,541	20,512	20,259	20,428
Diluted	21,740	21,661	21,492	21,146	21,521

2004 (As Previously Reported)	First Quarter	Second Quarter	Third Quarter	Forth Quarter	Total
Revenue	$18,487	$16,159	$16,078	$18,230	$68,954
Gross margin	$ 8,343	$ 7,489	$ 7,075	$ 8,286	$31,193
Net income	$ 2,940	$ 2,283	$ 1,667	$ 2,802	$ 9,692
Net income per share basic	$ 0.14	$ 0.11	$ 0.08	$ 0.14	$ 0.47
Net income per share diluted	$ 0.14	$ 0.11	$ 0.08	$ 0.13	$ 0.45

Shares used in calculating net income per share:					
Basic	20,409	20,541	20,512	20,259	20,428
Diluted	21,740	21,661	21,492	21,146	21,521

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SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS
(in thousands)

	Balance at the Beginning of the Period	Additions: Charge to Bad Debts Expense	Additions: Recoveries and Other	Deductions/ Write-Offs	Balance at the End of the Period
Allowance for Doubtful Accounts:					
2005	$200	$ 99	$ 30	$(129)	$200
2004	$387	$(140)	$	$ (47)	$200
2003	$439	$ (27)	$	$ (25)	$387

The Company specifically analyzes accounts receivable, historical bad debts, customer concentrations, customer credit-worthiness, current economic trends, and changes in its customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. Based on this analysis, the Company reduced the allowance for doubtful accounts by $140,000 and $27,000 in 2004 and 2003, respectively.

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SIGNATURES

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

SM&A

By: /s/ STEVEN S. MYERS

Steven S. Myers
Chairman and Chief Executive Officer
Dated: May 15, 2006

POWER OF ATTORNEY

KNOWN ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Steven S. Myers and Steve D. Handy his attorneys-in-fact, each with the power of substitution, for him in any and all capacities, to sign any amendments to this Report on Form 10-K, and to file the same, with Exhibits thereto and other documents in connection therewith with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or substitute or substitutes, may do or cause to be done by virtue thereof.

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

Name	Title	Date
/s/ STEVEN S. MYERS	Chairman of the Board and	May 15, 2006
Steven S. Myers	Chief Executive Officer (Principal Executive Officer)	
/s/ STEVE D. HANDY	Chief Financial Officer and Secretary	May 15, 2006
Steve D. Handy	(Principal Financial Officer and Principal Accounting Officer)	
/s/ WILLIAM C. BOWES	Director	May 15, 2006
William C. Bowes		
/s/ DWIGHT L. HANGER	Director	May 15, 2006
Dwight L. Hanger		
/s/ J. CHRISTOPHER LEWIS	Director	May 15, 2006
J. Christopher Lewis		
/s/ JOSEPH B. REAGAN	Director	May 15, 2006
Joseph B. Reagan		

/s/ ROBERT RODIN	Director	May 15, 2006
Robert Rodin		
/s/ JOHN P. STENBIT	Director	May 15, 2006
John P. Stenbit		
/s/ ROBERT J. UNTRACHT	Director	May 15, 2006
Robert J. Untracht		

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INDEX TO EXHIBITS

Exhibits (numbered in accordance with item 601 of Regulation S-K).

2.1 Stock Purchase and Sale Agreement, by and among the Registrant, Steven Myers Holding Inc. and L-3 Communications Corporation. (1)

2.2 Amendment No.1 to Stock Purchase and Sale Agreement, by and among the Registrant, Steven Myers Holding Inc. and L-3 Communications Corporation. (2)

3.1 Amended and Restated Articles of Incorporation. (3)

3.2 Amended and Restated Bylaws of the Registrant. (4)

10.1 Amended and Restated 1997 Stock Option Plan and related form of Stock Option Agreement. (5)

10.2 Second Amended and Restated Equity Incentive Plan. (6)

10.3 Amended and Restated Employee Stock Purchase Plan. (7)

10.4 Office Facility Lease. (8)

10.5 Amendment No. 1 to Office Facility Lease. (9)

10.6 Employment Agreement of Steven S. Myers. (10)

10.7 Amendment No. 1 to Employment Agreement of Steven S. Myers. (11)

10.8 Amendment No. 2 to Employment Agreement of Steven S. Myers. (12)

10.9 Amendment No. 3 to Employment Agreement of Steven S. Myers. (13)

10.10 Amendment No. 4 to Employment Agreement of Steven S. Myers. (14)

10.11 Amendment No. 5 to Employment Agreement of Steven S. Myers. (15)

10.12 Employment Agreement of Cathy L. Wood. (16)

10.13 Amendment No. 1 to Employment Agreement of Cathy L. Wood.(17)

10.14 Amendment No. 2 to Employment Agreement of Cathy L. Wood. (18)

10.15 Amendment No. 3 to Employment Agreement of Cathy L. Wood. (19)

10.16 Amendment No. 4 to Employment Agreement of Cathy L. Wood. (20)

10.17 Employment Agreement of Bennett C. Beaudry. (21)

10.18 Amendment No. 1 to Employment Agreement of Bennett C. Beaudry. (22)

10.19 Amendment No. 2 to Employment Agreement of Bennett C. Beaudry. (23)

10.20 Amendment No. 3 to Employment Agreement of Bennett C. Beaudry. [24]

10.21 Accounts Receivable Loan Agreement dated January 10, 2002, by and between the Registrant and City National Bank, a national banking association. [25]

10.22 Commercial Guaranty dated January 10, 2002, executed by Steven Myers & Associates, Inc. in favor of City National Bank, a national banking association. [26]

10.23 Revolving Loan Agreement dated October 14, 2003, by and between the registrant and City National Bank, a national association. [27]

10.24 Revolving Note dated April 10, 2003, executed by SM&A, in favor of City National Bank. [28]

10.25 Renewal of Revolving Note dated April 27, 2004, executed by SM&A, in favor of City National Bank. [29]

10.26 Renewal of Revolving Note dated April 29, 2005, executed by SM&A, in favor of City National Bank. [30]

10.27 Consultant Agreement of Bowes Enterprises. [31]

10.28 Consultant Agreement of Joseph B. Reagan. [32]

Table of Contents

Exhibits (continued)

21.1 Subsidiaries of the Registrant. [33]

23.1 Consent of Independent Registered Public Accounting Firm. [34]

31.1 Certificate of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. [35]

31.2 Certificate of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. [36]

32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. [37]

32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. [38]

Footnote #

(1) Filed on November 27, 2001 as Exhibit 10.1 to the registrant s Current Report on Form 8-K and incorporated herein by reference.

(2) Filed on December 14, 2001 as Exhibit 10.1 to the registrant s Current Report on Form 8-K and incorporated herein by reference.

(3) Filed on March 15, 2002 as Exhibit 3.1 to the registrant s Annual Report on Form 10-K and incorporated herein by

reference.

(4) Filed on May 3, 2002 as Exhibit 3.2 to the registrant s Quarterly Report on Form 10-Q and incorporated herein by reference.

(5) Filed on April 17, 2001 as Exhibit 10.1 to the registrant s Annual Report on Form 10-K and incorporated herein by reference.

(6) Filed herewith.

(7) Filed on April 29, 2002 as Exhibit C to the registrant s Annual Proxy Statement on Form 14A and incorporated herein by reference.

(8) Filed on November 21, 1997 as Exhibit 10.3 to the registrant s Registration Statement 333-4075 on Form S-1 (Registration No. 333-4075) and incorporated herein by

reference.

(9) Filed on October 22, 2004 as Exhibit 10.25 to the registrant s Quarterly Report on Form 10-Q and incorporated herein by reference.

(10) Filed on April 17, 2001 as Exhibit 10.17 to the registrant s Annual Report on Form 10-K and incorporated herein by reference.

(11) Filed on March 15, 2002 as Exhibit 10.7 to the registrant s Annual Report on Form 10-K and incorporated herein by reference.

(12) Filed on May 3, 2002 as Exhibit 10.8 to the registrant s Quarterly Report on Form 10-Q and incorporated herein by reference.

(13) Filed on March 11, 2003 as Exhibit 10.7 to the registrant s

Annual Report on Form 10-K and incorporated herein by reference.

(14) Filed on February 6, 2004 as Exhibit 10.8 to the registrant s Annual Report on Form 10-K and incorporated herein by reference.

(15) Filed on October 22, 2004 as Exhibit 10.21 to the registrant s Quarterly Report on Form 10-Q and incorporated herein by reference.

(16) Filed on March 15, 2002 as Exhibit 10.8 to the registrant s Annual Report on Form 10-K and incorporated herein by reference.

(17) Filed on November 4, 2002 as Exhibit 10.10 to the registrant s Quarterly Report on Form 10-Q and incorporated

herein by reference.

(18) Filed on March 11, 2003 as Exhibit 10.10 to the registrant s Annual Report on Form 10-K and incorporated herein by reference..

(19) Filed on February 6, 2004 as Exhibit 10.12 to the registrant s Annual Report on Form 10-K and incorporated herein by reference.

(20) Filed on October 22, 2004 as Exhibit 10.22 to the registrant s Quarterly Report on Form 10-Q and incorporated herein by reference.

(21) Filed on November 4, 2002 as Exhibit 10.11 to the registrant s Quarterly Report on Form 10-Q and incorporated herein by reference

(22)

Filed on March 11, 2003 as Exhibit 10.12 to the registrant s Annual Report on Form 10-K and incorporated herein by reference.

(23) Filed on February 6, 2004 as Exhibit 10.15 to the registrant s Annual Report on Form 10-K and incorporated herein by reference.

(24) Filed on October 8, 2004 as Exhibit 99.1 to the registrant s current report on 8-K and incorporated herein by reference.

(25) Filed on January 25, 2002 as Exhibit 99.2 to the registrant s Current Report on Form 8-K and incorporated herein by reference.

(26) Filed on January 25, 2002 as Exhibit 99.3 to the registrant s Current Report

on Form 8-K and incorporated herein by reference.

(27) Filed on February 6, 2004 as Exhibit 10.18 to the registrant s Annual Report on Form 10-K and incorporated herein by reference.

(28) Filed on July 31, 2003 as Exhibit 10.16 to the registrant s Quarterly Report on Form 10-Q and incorporated herein by reference.

(29) Filed on July 21, 2004 as Exhibit 10.20 to the registrant s Quarterly Report on Form 10-Q and incorporated herein by reference.

(30) Filed on July 14, 2005 as Exhibit 10.25 to the registrant s Quarterly Report on From 10-Q and incorporated herein by reference.

(31) Filed on October 22, 2004 as Exhibit 10.23 to the registrant s Quarterly Report on Form 10-Q and incorporated herein by reference.

(32) Filed on October 22, 2004 as Exhibit 10.24 to the registrant s Quarterly Report on Form 10-Q and incorporated herein by reference.

(33) Filed on March 11, 2003 as Exhibit 21.1 to the registrant s Annual Report on Form 10-K and incorporated herein by reference.

(34) Filed herewith.

(35) Filed herewith.

(36) Filed herewith.

(37) Filed herewith.

(38) Filed herewith.