WATSON WYATT & CO HOLDINGS
Form 10-Q
May 14, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2002

OR

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

For the transition period from _____ to _____

Commission File Number: 001-16159

WATSON WYATT & COMPANY HOLDINGS

(Exact name of registrant as specified in its charter)

| Delaware | 52-2211537 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

1717 H Street NW
Washington, DC 20006-3900

(Address of principal executive offices, including zip code)

**(202) 715-7000**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes X

No _

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of May 10, 2002.

| Class | Number of Shares |
|---|---|
| Class A Common Stock, $.01 par value | 20,100,728 |
| Class B Common Stock, $.01 par value | 12,910,857 |

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WATSON WYATT & COMPANY HOLDINGS
INDEX TO FORM 10-Q

For the Three and Nine Months Ended March 31, 2002

**WATSON WYATT & COMPANY HOLDINGS**
**Consolidated Statements of Operations**
(Thousands of U.S. Dollars, Except Share Data)

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | Three Months Ended March 31, | | | Nine Months Ended March 31, | | | |
| | | 2002 | | | | | | |
| | $ 176,345 | | | | | | | |
| 105,432 | 96,174 | | 300,646 | | 282,004 | | | |
| Professional and subcontracted services | | 11,270 | 14,199 | | 35,829 | | 40,494 | |
| Occupancy, communications and other | | 27,303 | 28,278 | | 81,518 | | 82,772 | |
| General and administrative expenses | | 14,043 | 14,081 | | 41,250 | | 42,186 | |
| Depreciation and amortization | | 4,922 | 6,139 | | 15,552 | | 18,175 | |
| | | 162,970 | | 158,871 | | 474,795 | | 465,631 |
| Income from operations | | 17,412 | 17,474 | | 52,940 | | 50,188 | |
| 302 | 285 | | 988 | | 694 | | | |
| Other non-operating income | | - | | - | | 1,000 | | - |
| Income from affiliates | | 793 | | 1,411 | | 2,888 | | 3,504 |
| Income before income taxes | | 18,507 | 19,170 | | 57,816 | | 54,386 | |

| | | | | | |
|---|---|---|---|---|---|
| Provision for income taxes | | 7,400 | 8,255 | 23,125 | 23,399 |
| Net income | | $ 11,107 | | | |
| | $ 0.33 | | | | |
| | $ 0.33 | | | | |
| 32,959 | 32,929 | | 32,995 | 31,770 | |
| Weighted average shares of common stock, diluted (000) | | 33,401 | 33,310 | 33,420 | 32,028 |

See accompanying notes

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**WATSON WYATT & COMPANY HOLDINGS**
**Consolidated Balance Sheets**
(Thousands of U.S. Dollars, Except Share Data)

| | March 31, 2002 | June 30, |
|---|---|---|
| | (Unaudited) | |
| **Assets** | | |
| Cash and cash equivalents | $ 68,741 | |
| Receivables from clients: | | |
| Billed, net of allowances of $2,970 and $2,695 | 90,012 | 84,361 |
| Unbilled, net of allowances of $858 and $1,130 | 69,346 | 67,229 |
| | 159,358 | 151,590 |
| Deferred income taxes | 13,581 | 13,581 |
| Other current assets | 13,261 | 11,027 |
| Total current assets | 254,941 | 257,933 |
| Investment in affiliates | 18,390 | 16,196 |
| Fixed assets, net of accumulated depreciation of $94,190 and $83,722 | 58,636 | 52,616 |
| Deferred income taxes | 38,526 | 38,526 |
| Goodwill and intangible assets | 16,709 | 13,374 |
| Other assets | 9,106 | 8,811 |
| **Total Assets** | $ 396,308 | |
| **Liabilities** | | |
| Accounts payable and accrued liabilities | $ 117,730 | |
| Income taxes payable | 13,019 | 13,622 |
| Total current liabilities | 130,749 | 161,762 |
| Accrued retirement benefits | 82,426 | 77,660 |

| | | | |
|---|---|---|---|
| Deferred rent and accrued lease losses | | 3,577 | 3,484 |
| Other noncurrent liabilities | | 27,166 | 25,825 |
| **Total Liabilities** | | 243,918 | 268,731 |
| Commitments and contingencies | | | |
| **Stockholders' Equity** | | | |
| Preferred Stock - No par value: | | | |
| 1,000,000 shares authorized | | | |
| None issued and outstanding | | -- | -- |
| | | | |
| 20,017,167 and 9,390,000 outstanding | 201 | 94 | |
| -- | | | |
| Class B-2 Common Stock - $.01 par value: | | | |
| 15,000,000 shares authorized; | | | |
| 12,910,857 and 13,244,355 issued and outstanding | | 129 | 132 |
| Additional paid-in capital | | 146,940 | |
| Treasury stock, at cost - 132,925 shares | -- | | |
| 14,798 | (19,893) | | |
| Cumulative translation adjustment (accumulated other comprehensive loss) | | (7,799 | |
| **Total Stockholders' Equity** | | 152,390 | 118,725 |
| **Total Liabilities and Stockholders' Equity** | $ 396,308 | $ 387,456 | |

See accompanying notes

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WATSON WYATT & COMPANY HOLDINGS

Consolidated Statements of Cash Flows

(Thousands of U.S. Dollars)

| | Nine Months Ended March 31, | |
|---|---|---|
| | 2002 | |
| | | |
| Net income | $ 34,691 | |
| Adjustments to reconcile net income to net cash from (used in) operating activities: | | |
| Provision for doubtful receivables from clients | 5,025 | 9,630 |
| Depreciation | 15,456 | 16,281 |
| Non cash compensation charge | -- | |

| | | | |
|---|---|---|---|
| Amortization of goodwill and intangible assets | | 96 | 1,894 |
| Income from affiliates | | (2,888 | |
| Other, net | | (1,179 | 721 |
| ) | (433 | | |
| Changes in operating assets and liabilities (net of discontinued operations) | | | |
| Receivables from clients | | (12,794 | |
| Other current assets | | (2,392) | |
| Other assets | | (295 | 1,974 |
| Accrued retirement benefits | 4,766 | (701) | |
| Net cash from (used in) operating activities | 10,187 | (8,052) | |

Cash flows used in investing activities: Purchases of fixed assets(22,120 )

(

17,763

)

Proceeds from divestitures1,681 443 Acquisitions and contingent consideration payments(3,583 )

(

7,040

)

Distributions from affiliates600 2,745

Net cash used in investing activities(23,422 )

(

21,615

)

Cash flows (used in) from financing activities: Issuances of common stock, net of offering costs291 35,025 Repurchases of common stock, net(1,670)-- Proceeds from stock purchase plan969-- Net repurchases of redeemable common stock--

(

116

)

Net cash (used in) from financing activities(410 )34,909

Effect of exchange rates on cash651

(

325

)

(Decrease) increase in cash and cash equivalents(12,994 )4,917 Cash and cash equivalents at beginning of period81,735 41,410

Cash and cash equivalents at end of period$ 68,741 $ 46,327

See accompanying notes

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**WATSON WYATT & COMPANY HOLDINGS**
**Consolidated Statement of Changes in Stockholders' Equity**
(Thousands of U.S. Dollars, Except Share Data)
(Unaudited)

| | Retained (Deficit) Earnings | Cumulative Translation Gain (Loss) | Class A Common Stock | Class B-1 Common Stock | Class B-2 Common Stock | Additional Paid-in Capital | Treasury Stock, at Cost | Total |
|---|---|---|---|---|---|---|---|---|
| Balance at June 30, 2001 | $ (19,893 ) | $ (8,361) | $ 94 | $ 104 | $ 132 | $ 146,649 | $ -- | $ 118,725 |
| Comprehensive income: | | | | | | | | |
| Net income | 34,691 | 34,691 | | | | | | |
| 562 | | | | | | | 562 | |
| | | | | | | | | 35,253 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Total comprehensive income | | | | | | | | |
| Reclassification for sale of 442,500 shares by existing stockholders | | | 4 | (4) | | | | -- |
| -- | | | | | | | | |
| its partners | | | 3 | | (3) | | | -- |
| Company Holdings | | | | | | | (209) | (209) |
| Repurchase of 70,325 shares | (1,670) | (1,670) | | | | | | |
| | | | -- | | 291 | 291 | | |
| Balance at March 31, 2002 | $ (7,799 | $ 129 | $ 146,940 | | | | | |

See accompanying notes

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WATSON WYATT & COMPANY HOLDINGS

Notes to the Consolidated Financial Statements

(Tabular amounts are in thousands, except per share data)

(Unaudited)

1. The accompanying unaudited quarterly consolidated financial statements of Watson Wyatt & Company Holdings and our subsidiaries (collectively referred to as "we," "Watson Wyatt" or the "Company") are presented in accordance with the rules and regulations of the Securities and Exchange Commission ("SEC") and do not include all of the disclosures normally required by accounting principles generally accepted in the United States of America. In the opinion of management, these statements reflect all adjustments, including recurring adjustments, which are necessary for a fair presentation of the consolidated financial statements for the interim periods. The consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2001, which is filed with the SEC and may be accessed via EDGAR on the SEC's web site at www.sec.gov.

The results of operations for the three and nine months ended March 31, 2002 are not necessarily indicative of the results that can be expected for the entire fiscal year ending June 30, 2002. The results reflect estimated bonuses ultimately accrued at management's discretion and anticipated tax rates. Certain prior year amounts have been reclassified to conform to the current period's presentation.

2. In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141, "Business Combinations" (FAS 141) and Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" (FAS 142). FAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Watson Wyatt has historically applied the purchase method of accounting to its acquisitions and will continue to do so in the future.

FAS 142 addresses the accounting for goodwill and intangible assets subsequent to their acquisition. FAS 142 provides that goodwill and indefinite-lived intangible assets will no longer be amortized and that these assets must be tested at least annually for impairment beginning in the year of adoption. FAS 142 also provides that the amortization of intangible assets with finite lives is not limited to 40 years. The Company adopted the provisions of FAS 142 effective July 1, 2001. The Company completed its transitional impairment testing of goodwill as of July 1, 2001, for all of its reporting units and concluded that no impairment of goodwill exists.

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The following table reflects consolidated results adjusted as though the adoption of FAS 142 occurred as of July 1, 2000:

| | Three Months Ended March 31, | | Nine Months Ended March 31, | |
|---|---|---|---|---|
| | 2002 | 2001 | 2002 | 2001 |
| Net income, as reported | $ 11,107 | $ 10,915 | $ 34,691 | $ 30,987 |
| Goodwill amortization, net of tax | | | | |

| | | | | |
|---|---|---|---|---|
| | -- | 361 | -- | 995 |
| Equity method goodwill amortization, net of tax | -- | 30 | -- | 90 |
| Net income, as adjusted | $ 11,107 | $ 11,306 | $ 34,691 | $ 32,072 |
| Basic earnings per share, as reported | $ | | | |

| | | | | |
|---|---|---|---|---|
| | 0.34 | $ 0.33 | $ 1.05 | $ 0.98 |
| Goodwill amortization, net of tax | -- | 0.01 | -- | 0.03 |
| Equity method goodwill amortization, net of tax | -- | -- | -- | -- |
| Basic earnings per share, as adjusted | $ 0.34 | $ 0.34 | $ 1.05 | |

$

1.01

Diluted earnings per share, as reported

$

0.33

$

0.33

$

1.04

$

0.97

Goodwill amortization, net of tax

--

0.01

--

0.03

Equity method goodwill amortization, net of tax

--

--

--

--

Diluted earnings per share, as adjusted

| | |
|---|---|
| $ | 0.33 |
| $ | 0.34 |
| $ | 1.04 |
| $ | 1.00 |

The changes in the carrying amount of goodwill for the nine months ended March 31, 2002 are as follows:

| | Benefits Group | eHR Group | Human Capital Group | International | Other | Total |
|---|---|---|---|---|---|---|
| Balance as of June 30, 2001 | $ 10,807 | $ 724 | $ 59 | $ 19 | $ 1,214 | $ 12,823 |
| Goodwill recorded during the period | | | | | | 3,075 |
| | | | | | | 225 |

| | |
|---|---|
| | -- |
| | -- |
| | 283 |
| | 3,583 |
| Impairment losses | |
| | -- |
| | -- |
| | -- |
| | -- |
| | -- |

--

Translation adjustment

(150

)

--

(2

)

--

--

(152

)

Balance as of March 31, 2002

$

13,732

| | |
|---|---|
| $ | 949 |
| $ | 57 |
| $ | 19 |
| $ | 1,497 |
| $ | 16,254 |

6

The following table reflects the components of intangible assets at March 31, 2002:

| | Gross Carrying Amount | Accumulated Amortization |
|---|---|---|
| Amortizable intangible assets: | | |

| | | |
|---|---|---|
| Non-compete agreements | $ 672 | $ 289 |
| Purchased software | 125 | 53 |
| Total amortizable intangible assets | $ 797 | $ 342 |

The weighted average remaining life of amortizable intangible assets at March 31, 2002 was 3.9 years. Amortization expense for the nine months ended March 31, 2002 was $96,000. Estimated amortization expense for fiscal year 2002 and each of the four succeeding fiscal years is as follows:

| Fiscal year ending June 30: | Amount |
|---|---|
| 2002 | $ 128 |
| 2003 | 128 |
| 2004 | 117 |
| 2005 | 95 |
| 2006 | 63 |

3. In the third quarter of fiscal year 1998, we discontinued our benefits administration outsourcing business, including our investment in our affiliate, Wellspring Resources, LLC ("Wellspring"). We believe we have adequate provisions for any remaining costs associated with our obligations related to the benefits administration outsourcing business. All Wellspring related activity is reflected on the Statements of Cash Flows as discontinued operations.

4. In North America, the Company is primarily organized and managed by practice. Although our consultants in our international offices provide services in these same practice areas, our international operations as a whole are managed geographically and comprise a single operating segment. Therefore, we have 5 reportable operating segments:

(1) Benefits Group
(2) eHR Group
(3) Human Capital Group
(4) International
(5) Other (including Data Services and Communications)



The Company evaluates the performance of its segments and allocates resources to them based on net operating income. Prior year data has been restated to be consistent with current classifications for comparative purposes.

The table below presents specified information about reported segments as of and for the three months ended March 31, 2002:

| Benefits Group | eHR Group | Human Capital | International | Other | Total |
|---|---|---|---|---|---|

| | Group | | | | | |
|---|---|---|---|---|---|---|
| Revenue (net of reimbursable expenses) | $ 104,392 | $ 25,742 | $ 12,465 | $ 17,387 | $ 12,688 | $ 172,674 |
| Net operating income/(loss) | 30,112 | 4,233 | (1,098 ) | 578 | (422 ) | 33,403 |
| Receivables | 93,779 | 20,184 | 10,988 | 14,302 | 11,077 | 150,330 |

The table below presents specified information about reported segments as of and for the three months ended March 31, 2001:

| | Benefits Group | eHR Group | Human Capital Group | International | Other | Total |
|---|---|---|---|---|---|---|
| Revenue (net of reimbursable expenses) | $ 98,994 | $ 23,768 | $ 13,597 | $ 16,880 | $ 14,953 | $ 168,192 |
| Net operating income/(loss) | 27,266 | 5,694 | 549 | 1,769 | (93 ) | 35,185 |
| Receivables | 98,051 | 16,052 | 13,230 | 15,727 | 10,434 | 153,494 |

The table below presents specified information about reported segments as of and for the nine months ended March 31, 2002:

| | Benefits Group | eHR Group | Human Capital Group | International | Other | Total |
|---|---|---|---|---|---|---|
| Revenue (net of reimbursable expenses) | $ 292,700 | $ 81,089 | $ 36,571 | $ 51,030 | $ 43,395 | $ 504,785 |
| Net operating income/(loss) | 73,263 | 16,822 | (4,730 ) | 941 | 1,750 | 88,046 |
| Receivables | 93,779 | 20,184 | 10,988 | 14,302 | 11,077 | 150,330 |

The table below presents specified information about reported segments as of and for the nine months ended March 31, 2001:

| | Benefits Group | eHR Group | Human Capital Group | International | Other | Total |
|---|---|---|---|---|---|---|
| Revenue (net of reimbursable expenses) | $ 275,779 | $ 73,209 | $ 42,083 | $ 52,794 | $ 48,272 | $ 492,137 |
| Net operating income/(loss) | 66,014 | 21,528 | 5,728 | 6,821 | 5,871 | 105,962 |
| Receivables | 98,051 | 16,052 | 13,230 | 15,727 | 10,434 | 153,494 |

Information for the three and nine months ended March 31, 2001 has been restated to reflect the realignment of a group of U.S. consultants who deal with large multinational assignments into the "Benefits Group" from "Other." The amounts reclassified include revenue and expenses of $1,888,000 for the three months ended March 31, 2001, revenue and expenses of $5,752,000 for the nine months ended March 31, 2001, and receivables of $2,586,000 for both periods.

Information about interest income and tax expense is not presented as a segment expense because it is not considered a responsibility of the segments' operating management.



A reconciliation of the information reported by segment to the consolidated amounts follow for the three and nine month periods ended March 31, 2002 and 2001:

| | Three Months Ended March 31, | Nine Months Ended March 31, |
|---|---|---|
| | 200 | |
| 2 | | |
| | 200 | |
| 1 | | |
| | 200 | |
| 2 | | |
| | 200 | |
| 1 | | |

Revenue:

| | | | | |
|---|---|---|---|---|
| Total segment revenue | $ 172,674 | $ 168,192 | $ 504,785 | $ 492,137 |
| Reimbursable expenses not included in total segment revenue | 7,939 | 8,765 | 22,438 | 25,438 |
| Other, net | (231 | | | |

)

(612

)

512

(1,756

)

| | | | | |
|---|---|---|---|---|
| Consolidated revenue | $ 180,382 | $ 176,345 | $ 527,735 | $ 515,819 |

Net Operating Income:

Total segment net operating income

$
33,403
$
35,185
$
88,046
$
105,962

Income from affiliates
793
1,411
2,888
3,504

Differences in allocation methods for

depreciation, G&A and pension costs
(
1,562
)
1,946
(
2,072
)

(

1,748 )

Gain on sale of U.S. based public plan

retirement business

--

--

1,000

--

Discretionary compensation

(

13,716

)

(15,930

)

(

32,530

)

(49,030

)

IPO-related compensation charge

--

--

--

(3,480

)

Other, net

(411

)

(3,442

)

484

(822

)

Consolidated pretax income from continuing

operations

$

18,507

$

19,170

$

57,816

$

54,386

Receivables:

| | | | | |
|---|---|---|---|---|
| Total segment receivables - billed and unbilled | $ 150,330 | $ 153,494 | $ 150,330 | $ 153,494 |
| Net valuation differences | 9,028 | 3,100 | 9,028 | 3,100 |
| Total billed and unbilled receivables | 159,358 | 156,594 | | |

| | | | | |
|---|---|---|---|---|
| | 159,358 | 156,594 | | |
| Assets not reported by segment | 236,950 | 196,501 | 236,950 | 196,501 |
| Consolidated assets | $ 396,308 | $ 353,095 | $ 396,308 | $ 353,095 |

5. Basic earnings per share is calculated on the basis of the weighted average number of common shares outstanding. Diluted earnings per share is calculated on the basis of the weighted average number of common shares outstanding plus the effect of outstanding stock options using the "treasury stock" method. The components of basic and diluted earnings per share are as follows:

| | Three Months Ended March 31, | Nine Months Ended March 31, |
|---|---|---|

200

2

200

1

200

2

200

1

Net income

$

11,107

$

10,915

$

34,691

$

30,987

| | | | | |
|---|---|---|---|---|
| Weighted average outstanding shares of common stock | 32,959 | 32,929 | 32,995 | 31,770 |
| Dilutive effect of employee stock options | 442 | 381 | 425 | 258 |
| Common stock and stock equivalents | 33,401 | 33,310 | 33,420 | 32,028 |
| Earnings per share: | | | | |
| Basic | $ 0.34 | $ 0.33 | $ | |

| | |
|---|---|
| | 1.05 |
| $ | 0.98 |
| Diluted | |
| $ | 0.33 |
| $ | 0.33 |
| $ | 1.04 |
| $ | 0.97 |

6. From time to time, we are a party to various lawsuits, arbitrations or mediations, typically involving claims relating to the rendering of professional services or employment matters. Management believes that the results of all such proceedings will not have a material adverse effect on our financial condition. We carry professional liability insurance with a self-insured retention of $1 million per occurrence, which provides coverage for professional liability claims including the cost of defending such claims. The first $5 million of coverage beyond this retention is written by an affiliated captive insurance company owned by four professional services firms whose premium structure provides for recovering approximately 75% of any loss up to $5 million through increased insurance premiums over the following five years. The Company has provided for the self-insured retention and for the prospective premium increases where estimated losses in excess of $1 million are considered probable. We also carry employment practices liability insurance. For further details, refer to Part II, Item 1, "Legal Proceedings," on page 21.

7. On November 19, 2001, the Board of Directors approved a plan to purchase up to 1,150,000 shares of the Company's class A common stock for purposes which may include offsetting any potential dilution from shares which may be issued in connection with the Company's employee benefit plans.

8. On March 19, 2001, the Board of Directors approved the creation of an employee stock purchase plan for all associates and a restricted stock program for senior associates. The proposed employee stock purchase plan and the restricted stock program were approved at the annual stockholders' meeting on November 5, 2001, and were implemented in the beginning of calendar year 2002. Management currently anticipates that these programs will not

dilute earnings per share.

9. Comprehensive income includes net income and changes in the cumulative currency translation adjustment gain or loss. For the three months ended March 31, 2002, comprehensive income totaled $11.5 million, compared with $11.1 million for the three months ended March 31, 2001. For the nine months ended March 31, 2002, comprehensive income totaled $35.3 million, compared with $29.5 million for the nine months ended March 31, 2001.



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10. Effective August 31, 2001, we sold our U.S. based public sector retirement business to Gabriel, Roeder, Smith & Company ("GRS"). The sale included approximately 120 U.S. public sector retirement clients, representing approximately $6.0 million in annual revenues.

In accordance with the terms of the sale, GRS paid $1.0 million to the Company during the first quarter of this fiscal year. The amount of additional contractual cash payments over the next five years are contingent upon the successful transition of certain clients to GRS and upon their retention by GRS. The Company has also elected to receive approximately 7% of the common stock of GRS in lieu of a portion of future cash payments. The total potential value of stock and cash proceeds from the sale is anticipated to be $3.3 million, subject to the contingencies noted above.

Simultaneous with the sale, we entered into an alliance agreement with GRS under which we will mutually refer future business opportunities and explore joint consulting assignments.

11. In conjunction with the Company's review of its overhead cost structure in the second quarter of fiscal year 2002, the Company examined the classification of its operating expenses. This review included the identification and evaluation of the costs that comprise General and administrative expenses. Prior to the second quarter of fiscal year 2002, expenses associated with and incurred by various associates from our practice groups (the "Practice Support Team"), for the centralized development of practice-specific tools and services, were included in General and administrative expenses. The costs associated with the Practice Support Team are mainly comprised of the salaries and employee benefits and professional services expenses incurred by the associates on this team.

As a result of our review, we have reclassified the Practice Support Team's expenses from the beginning of fiscal year 1998 through the first quarter of fiscal year 2002 as components of Salaries and employee benefits, Professional and subcontracted services, and Occupancy, communications and other expenses. These expenses have previously been included as a component of General and administrative expenses and represent less than 2.5% of total operating expenses and revenue for the three and nine months ended March 31, 2001. Revenue, Income from operations, Income before income taxes, and Net income were unaffected by this reclassification.

For more information on the Company's reclassification of our Practice Support Team's expenses, refer to the Company's Form 8-K that was filed on January 24, 2002.

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

General

Watson Wyatt is a global provider of human capital consulting services. We operate from 61 offices in 18 countries throughout North America, Asia-Pacific and Latin America. We provide services in three principal practice areas: benefits, human resources technologies (eHR) and human capital consulting. Watson Wyatt & Company, which became a wholly-owned subsidiary of Watson Wyatt & Company Holdings as a result of our corporate reorganization and initial public offering in October 2000, was incorporated in Delaware on February 17, 1958. Watson Wyatt & Company Holdings was incorporated in Delaware on January 7, 2000. Including our predecessors, we have been in business since 1946. In 1995, we entered into an alliance agreement with R. Watson & Sons, now Watson Wyatt LLP, a United Kingdom based actuarial, benefits and human resources limited liability consulting partnership that was founded in 1878. We conducted business as The Wyatt Company until changing our corporate name to Watson Wyatt & Company in connection with the establishment of the Watson Wyatt Worldwide alliance. Since 1995, we and our alliance partners have marketed our services globally and seamlessly under the Watson Wyatt Worldwide brand, sharing resources, technologies, processes and business referrals.



The Watson Wyatt Worldwide global alliance maintains 87 offices in 30 countries and employs over 6,200 associates. Watson Wyatt & Company operates 61 offices in 18 countries in North America, Asia-Pacific and Latin America. Watson Wyatt LLP operates 10 offices in the United Kingdom and Ireland. The alliance operates 16 offices in 10 continental European countries principally through a jointly owned holding company, Watson Wyatt Holdings (Europe) Limited, which is 25% owned by Watson Wyatt and 75% owned by Watson Wyatt LLP.

Watson Wyatt's principal executive offices are located at 1717 H Street NW, Washington, DC 20006. Our web site is www.watsonwyatt.com. Information on this website is not a part of this filing.

We employ approximately 4,200 associates as follows:

| | |
|---|---|
| Benefits Group | 1,590 |
| eHR Group | 450 |
| Human Capital Group | 240 |
| International | 960 |
| Other (Including Data Services and Communications) | 740 |
| Corporate | 220 |
| Total | 4,200 |

Principal Services

We focus on the following core consulting areas:

Benefits

: The Benefits Group provides analysis, design and implementation of retirement programs, including actuarial services and required reporting of plan contributions and funding levels, group health benefit plan design and provider selection, defined contribution plan design and related services, and investment consulting services.

eHR:

The eHR Group develops technology-based