FTI CONSULTING INC
Form 10-Q
November 09, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2006

OR

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

For the transition period from to

Commission file number 001-14875

FTI CONSULTING, INC.

(Exact Name of Registrant as Specified in its Charter)

Maryland	**52-1261113**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
500 East Pratt Street, Suite 1400, Baltimore, Maryland	**21202**
(Address of Principal Executive Offices)	**(Zip Code)**

(410) 951-4800

(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 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 x Accelerated filer ¨ Non-accelerated filer ¨

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

Indicate the number of shares outstanding of each of the issuer s classes of common equity, as of the latest practicable date.

Class	**Outstanding at October 31, 2006**
Common stock, par value $0.01 per share	41,577,955

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FTI CONSULTING, INC. AND SUBSIDIARIES

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

FTI Consulting, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(in thousands, except per share data)

	December 31, 2005	September 30, 2006 (unaudited)
Assets		
Current assets		
Cash and cash equivalents	$ 153,383	$ 22,491
Accounts receivable		
Billed receivables	87,947	125,958
Unbilled receivables	56,871	72,981
Allowance for doubtful accounts and unbilled services	(17,330)	(20,827)
	127,488	178,112
Notes receivable	2,713	7,528
Prepaid expenses and other current assets	8,147	27,215
Deferred income taxes	6,404	9,816
Total current assets	298,135	245,162
Property and equipment, net	29,302	33,612
Goodwill	576,612	647,317
Other intangible assets, net	21,454	33,442
Notes receivable, net of current portion	6,516	35,687
Other assets	27,445	35,657
Total assets	$ 959,464	$ 1,030,877
Liabilities and Stockholders Equity		
Current liabilities		
Accounts payable, accrued expenses and other	$ 21,762	$ 33,530
Accrued compensation	72,688	56,399
Billings in excess of services provided	10,477	10,746
Total current liabilities	104,927	100,675
Long-term debt, net of current portion	348,431	348,361
Deferred income taxes	33,568	45,648
Other liabilities	18,269	24,662
Commitments and contingent liabilities (notes 3, 5, 6, 7 and 10)		
Stockholders equity		
Preferred stock, $0.01 par value; 5,000 shares authorized; none outstanding		
Common stock, $0.01 par value; 75,000 shares authorized; 39,009 shares issued and outstanding 2005; and 40,299 shares issued and outstanding 2006	390	403
Additional paid-in capital	238,055	259,547
Unearned compensation	(11,089)	
Retained earnings	226,913	251,581

Total stockholders equity		454,269		511,531
Total liabilities and stockholders equity	$	959,464	$	1,030,877

The accompanying notes are an integral part of these consolidated financial statements.

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FTI Consulting, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations

(in thousands, except per share data)

Unaudited

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	**2006**	**2005**	**2006**
Revenues	$ 133,189	$ 162,068	$ 373,720	$ 491,092
Operating expenses				
Direct cost of revenues	73,341	91,554	202,878	276,896
Selling, general and administrative expense	32,587	39,711	90,030	121,547
Special charges (note 7)		22,972		22,972
Amortization of other intangible assets	1,952	2,551	4,309	8,310
	107,880	156,788	297,217	429,725
Operating income	25,309	5,280	76,503	61,367
Other income (expense)				
Interest income	548	411	912	1,887
Interest expense and other	(4,875)	(6,103)	(9,104)	(17,992)
Loss on early extinguishment of terms of loans	(1,687)		(1,687)	
Litigation settlement gains (losses), net	21	688	(991)	419
	(5,993)	(5,004)	(10,870)	(15,686)
Income before income tax provision	19,316	276	65,633	45,681
Income tax provision	8,113	562	27,566	21,013
Net income (loss)	$ 11,203	$ (286)	$ 38,067	$ 24,668
Earnings (loss) per common share basic	$ 0.28	$ (0.01)	$ 0.91	$ 0.63
Earnings (loss) per common share diluted	$ 0.27	$ (0.01)	$ 0.90	$ 0.61

The accompanying notes are an integral part of these consolidated financial statements.

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FTI Consulting, Inc. and Subsidiaries

Condensed Consolidated Statement of Stockholders Equity

(in thousands)

Unaudited

	Common Stock		Additional			
			Paid-in	Unearned	Retained	
	Shares	Amount	Capital	Compensation	Earnings	Total
Balance, January 1, 2006	39,009	$ 390	$ 238,055	$ (11,089)	$ 226,913	$ 454,269
Issuance of common stock in connection with:						
Exercise of options, including income tax benefit of $1,236	338	3	7,062			7,065
Employee stock purchase plan	402	4	8,432			8,436
Restricted share grants, net of forfeitures	85	1	(1)			
Business combinations	1,065	11	30,124			30,135
Purchase and retirement of common stock	(600)	(6)	(23,370)			(23,376)
Reclassification due to adoption of new accounting standard (note 2)			(11,089)	11,089		
Share-based compensation			10,334			10,334
Net income					24,668	24,668
Balance, September 30, 2006	40,299	$ 403	$ 259,547	$	$ 251,581	$ 511,531

The accompanying notes are an integral part of these consolidated financial statements.

FTI Consulting, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(in thousands)

Unaudited

	Nine Months Ended September 30,	
	2005	**2006**
Operating activities		
Net income	$ 38,067	$ 24,668
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and other amortization	8,308	9,394
Amortization of other intangible assets	4,309	8,310
Provision for doubtful accounts, net	2,945	6,060
Non-cash share-based compensation	1,374	10,708
Income tax benefit from stock option exercises and other	1,188	
Loss on early extinguishment of term loans	1,687	
Excess tax benefits from share-based compensation		(910)
Loss on subleased facilities	920	
Impairment of other intangible assets		933
Non-cash interest expense	1,338	1,797
Other	718	(17)
Changes in operating assets and liabilities, net of effects from acquisitions:		
Accounts receivable, billed and unbilled	(31,471)	(50,724)
Notes receivable	1,467	(33,985)
Prepaid expenses and other assets	(3,414)	(5,940)
Accounts payable, accrued expenses and other	6,985	10,140
Accrued special charges		18,590
Income taxes payable	4,261	(5,206)
Accrued compensation	6,115	(24,748)
Billings in excess of services provided	(1,294)	27
Net cash provided by (used in) used in operating activities	43,503	(30,903)
Investing activities		
Payments for acquisition of businesses, including contingent payments and acquisition costs, net of cash received	(50,972)	(69,756)
Purchases of property and equipment	(12,077)	(13,803)
Proceeds from note receivable due from purchasers of former subsidiary	5,525	
Change in other assets	(134)	247
Net cash used in investing activities	(57,658)	(83,312)
Financing activities		
Issuance of debt securities	350,000	
Purchase and retirement of common stock	(133,088)	(23,376)
Issuance of common stock under equity compensation plans	5,016	6,471
Excess tax benefits from share-based compensation		910
Borrowings under long-term credit facilities	50,000	400
Payments of long-term debt	(155,000)	(15)

Borrowings under revolving line of credit	33,500	
Payments of revolving line of credit	(33,500)	
Payment of debt financing fees	(13,034)	(393)
Other	(186)	(674)
Net cash provided by (used in) financing activities	103,708	(16,677)
Net increase (decrease) in cash and cash equivalents	89,553	(130,892)
Cash and cash equivalents, beginning of period	25,704	153,383
Cash and cash equivalents, end of period	$ 115,257	$ 22,491

The accompanying notes are an integral part of these consolidated financial statements.

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FTI Consulting, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(amounts in tables expressed in thousands, except per share data)

Unaudited

1. Basis of Presentation and Significant Accounting Policies

Our unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States and under the rules and regulations of the Securities and Exchange Commission for interim financial information. Some of the information and footnote disclosures normally included in annual financial statements have been condensed or omitted pursuant to those rules or regulations. In management s opinion, the interim financial statements reflect all adjustments that are necessary for a fair presentation of the results for the interim periods presented. All adjustments made were normal recurring accruals. You should not expect the results of operations for interim periods to necessarily be an indication of the results for a full year. You should read these financial statements in conjunction with the consolidated financial statements and the notes contained in our annual report on Form 10-K for the year ended December 31, 2005.

Earnings per Common Share. Basic earnings per common share is calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per common share adjusts basic earnings per share for the effects of potentially dilutive common shares. Potentially dilutive common shares primarily include the dilutive effects of shares issuable under our stock option and long-term incentive plans, including restricted shares using the treasury stock method; and shares issuable upon conversion of our convertible senior subordinated notes using the if-converted method. Since the average price per share of our common stock was below the conversion price of our convertible notes, the convertible notes did not have a dilutive effect on our earnings per share for any of the periods presented. Until the market price of our common stock exceeds $31.25 per share, the conversion feature of the convertible notes will not have an impact on the number of shares utilized to calculate diluted earnings per share. When the market price of our common stock exceeds $31.25 per share, the number of shares that would be issued if the convertible notes were converted will be included as outstanding shares in the calculation of the diluted earnings per share.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	**2006**	**2005**	**2006**
Numerator basic and diluted				
Net income (loss)	$ 11,203	$ (286)	$ 38,067	$ 24,668
Denominator				
Weighted average number of common shares outstanding basic	40,177	39,236	41,760	39,338
Effect of dilutive stock options	715		550	582
Effect of dilutive restricted shares	165		56	192
Effect of accelerated stock repurchase agreement	113		38	
Weighted average number of common shares outstanding diluted	41,170	39,236	42,404	40,112
Earnings (loss) per common share basic	$ 0.28	$ (0.01)	$ 0.91	$ 0.63
Earnings (loss) per common share diluted	$ 0.27	$ (0.01)	$ 0.90	$ 0.61
Antidilutive stock options and restricted shares	1,316	6,063	2,555	1,889

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FTI Consulting, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (continued)

(amounts in tables expressed in thousands, except per share data)

Unaudited

Supplemental Cash Flow Information.

	Nine Months Ended September 30,	
	2005	**2006**
Other non-cash investing and financing activities		
Issuance of common stock to acquire businesses	$ 30,346	$ 30,135

Share-Based Compensation Expense. In December 2004, the Financial Accounting Standards Board, or FASB, issued Statement No. 123(R), Share-Based Payment, which is a revision of Statement No. 123, Accounting for Share-Based Compensation, and supersedes Accounting Principles Board, or APB, Opinion No. 25, Accounting for Stock Issued to Employees. Effective January 1, 2006, we adopted Statement No. 123(R) using the modified prospective method under which prior period amounts are not restated for comparative purposes. Under the modified prospective method, we are required to recognize compensation cost:

- for all share-based payments granted after January 1, 2006 based on the requirements of Statement No. 123(R) and
- for all unvested awards granted prior to January 1, 2006 using the compensation cost calculated for pro forma disclosure purposes under Statement No. 123.

Under Statement No. 123(R), we are required to recognize all share-based payments to employees and non-employee directors in our financial statements based on their grant date fair values, using prescribed option-pricing models. We use the Black-Scholes option pricing model to value share-based payments. However, we use a lattice model to value options that vest upon the earlier of the achievement of a service condition or the achievement of a market condition. Compensation expense related to share-based awards is recognized on a straight-line basis based on the value of share awards that are scheduled to vest during the requisite service period. Under Statement No. 123(R), share-based compensation expense is based on awards ultimately expected to vest and must be reduced for estimated forfeitures.

As a result of adopting Statement No. 123(R), our results of operations are different than they would have been if we had continued to account for share-based compensation under APB Opinion No. 25. If we had continued to account for share-based compensation under APB Opinion No. 25:

- for the three months ended September 30, 2006,
  - our income before income taxes would have been $2.8 million higher;
  - our net income would have been $2.0 million higher;

our basic earnings per share would have been $0.05 higher than our reported basic loss per share of $0.01; and

our diluted earnings per share would have been $0.05 higher than our reported diluted loss per share of $0.01; and

for the nine months ended September 30, 2006,

our income before income taxes would have been $8.3 million higher;

our net income would have been $6.2 million higher;

our basic earnings per share would have been $0.15 higher than our reported basic earnings per share of $0.63; and

FTI Consulting, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (continued)

(amounts in tables expressed in thousands, except per share data)

Unaudited

our diluted earnings per share would have been $0.15 higher than our reported diluted earnings per share of $0.61.
Upon adoption of Statement No. 123(R), we reclassified our unamortized unearned compensation related to the issuance of unvested restricted stock awards to additional paid-in capital in our balance sheet.

Prior to the adoption of Statement No. 123(R), we presented all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in our statement of cash flows. Statement No. 123(R) requires the cash flows resulting from the tax benefits of tax deductions in excess of compensation cost recognized for those options, referred to as excess tax benefits, to be classified as financing cash flows. The $0.9 million excess tax benefit classified as a financing cash inflow would have been classified as an operating cash inflow if we had not adopted Statement No. 123(R).

In November 2005, the FASB issued FASB Staff Position, or FSP, No. FAS 123(R)-3, Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards. We have elected to adopt the alternative transition method provided in FSP No. 123(R)-3 for calculating the tax effects of share-based compensation. The alternative transition method includes a simplified method to establish the beginning balance of the additional paid-in capital pool related to the tax effects of employee share-based compensation.

Significant New Accounting Pronouncements. On July 13, 2006, the FASB issued Interpretation, or FIN, No. 48, Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109. FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in our financial statements. It also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, among other things. The provisions of FIN No. 48 are effective for us beginning January 1, 2007. We do not believe the adoption of this accounting pronouncement will have a material effect on our financial position, results of operations or cash flows.

In September 2006, the FASB issued Statement No. 157, Fair Value Measurements. Statement No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosure requirements regarding fair value measurements. Statement No. 157 does not require any new fair value measurements. We are required to adopt the provisions of Statement No. 157 effective January 1, 2008 although earlier adoption is permitted. We do not believe the adoption of this standard will have a material effect on our financial position, results of operations or cash flows.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin, or SAB, No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements, which provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB No. 108 requires registrants to quantify misstatements using both the balance sheet and income statement approaches and to evaluate whether either approach results in quantifying an error that is material based on relevant quantitative and qualitative factors. The guidance is effective for the first fiscal period ending after November 15, 2006. We are currently evaluating the impact of adopting SAB No. 108 on our financial position, results of operations and cash flows.

Reclassifications. Certain amounts in the 2005 financial statements have been reclassified to conform to the 2006 presentation.

FTI Consulting, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (continued)

(amounts in tables expressed in thousands, except per share data)

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2. Share-Based Compensation

Share-Based Incentive Compensation Plans. Our 1997 Stock Option Plan, as amended, provides for the issuance of up to 11,587,500 shares of common stock to employees and non-employee directors. Under the terms of the 1997 plan, we may grant option rights or shares of restricted and unrestricted common stock to employees. As of September 30, 2006, 76,625 shares of common stock are available for grant under our 1997 Stock Option Plan.

Our 2004 Long-Term Incentive Plan, as amended, provides for grants of option rights, appreciation rights, restricted or unrestricted shares, performance awards or other share-based awards to our officers, employees, non-employee directors and individual service providers. We are authorized to issue up to 3,000,000 shares of common stock under the 2004 plan, of which no more than 600,000 shares of common stock may be issued in the form of restricted or unrestricted shares, performance awards or other share-based awards. As of September 30, 2006, 290,223 shares of common stock are available for grant under our 2004 Long-Term Incentive Plan.

On June 6, 2006, our stockholders approved the FTI Consulting, Inc. 2006 Global Long-Term Incentive Plan. This plan, as amended, provides for grants of option rights, appreciation rights, restricted or unrestricted shares, performance awards or other share-based or cash-based awards to our officers, employees, non-employee directors and individual service providers. We are authorized to issue up to 3,500,000 shares of common stock under the 2006 plan, of which no more than 1,100,000 shares of common stock may be issued in the form of restricted or unrestricted shares, performance awards or other share-based awards. As of September 30, 2006, 3,415,000 shares of common stock are available for grant under our 2006 Global Long-Term Incentive Plan.

On June 6, 2006, our stockholders approved the FTI Consulting, Inc. Deferred Compensation Plan for Key Employees and Non-Employee Directors. The deferred compensation plan provides for grants of stock unit and restricted stock unit awards to our key employees, other highly-compensated employees and non-employee directors. We are authorized to issue up to 1,500,000 shares of common stock under the deferred compensation plan. As of September 30, 2006, 1,462,500 shares of common stock are available for grant under our Deferred Compensation Plan for Key Employees and Non-Employee Directors.

Options are granted to employees with exercise prices equal to or exceeding the market value of our common stock on the grant date and expire ten years subsequent to award. Vesting provisions for individual awards are established at the grant date at the discretion of the compensation committee of our board of directors. Options granted under our share-based incentive compensation plans generally vest over three to six years, although we have granted options that vest over eight years. Restricted shares are generally contingent on continued employment and vest over periods of three to ten years. Our share-based incentive compensation plans provide for accelerated vesting if there is a change in control, as defined in the applicable plan. The employment agreements with executive officers and other employees provide for accelerated vesting on other events, including death, disability, termination without good cause and termination by the employee with good reason. We issue new shares of our common stock whenever stock options are exercised or share awards are granted.

Periodically we issue restricted and unrestricted shares to employees upon employment or in connection with performance evaluations. The fair market value on the date of issue of unrestricted shares is immediately charged to compensation expense. The fair market value on the date of issue of restricted shares is charged to compensation expense ratably over the remaining service period as the restrictions lapse.

Employee Stock Purchase Plan. The FTI Consulting, Inc. Employee Stock Purchase Plan allows eligible employees to subscribe to purchase shares of common stock through payroll deductions of up to 15% of eligible compensation, subject to limitations. The purchase price is the lower of 85% of the fair market value of our common stock on the first trading day or the last trading day of each semi-annual offering period. The aggregate

FTI Consulting, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (continued)

(amounts in tables expressed in thousands, except per share data)

Unaudited

number of shares purchased by an employee may not exceed $25,000 of fair market value annually, subject to limitations imposed by Section 423 of the Internal Revenue Code. A total of 2,300,000 shares of common stock are authorized for purchase under the plan. As of September 30, 2006, 120,439 shares of our common stock are available for purchase under the plan. Employees purchased shares of common stock under this plan during the following periods at the weighted average prices per share as indicated: three months ending September 30, 2005 197,390 at $17.77; three months ending September 30, 2006 257,619 at $22.75; nine months ending September 30, 2005 307,388 at $16.41; and nine months ending September 30, 2006 402,299 at $20.97.

On June 6, 2006, our stockholders approved the FTI Consulting, Inc. 2007 Employee Stock Purchase Plan. A total of 2,000,000 shares of common stock are authorized for purchase under the plan. The provisions of the plan are substantially the same as the provisions under our existing employee stock purchase plan described above. No shares of common stock may be purchased under this plan until 2007.

Share-Based Compensation Expense. We use the Black-Scholes option-pricing model and a lattice model to value our option and purchase plan grants using the assumptions in the following table. The risk-free interest rate is based on the yield curve of U.S. Treasury strip securities with remaining terms similar to the expected term of the option or purchase plan award. The dividend yield on our common stock is assumed to be zero since we do not pay dividends and have no current plans to do so in the future. To estimate the market price volatility of our common stock, we use the historical volatility of our common stock over a time period equal to the expected term of the option or purchase plan award. The expected life of option grants is based on historical observations of the actual time lapsed between the grant date and exercise date. Groups of option holders that have similar historical exercise behavior with regard to option exercise timing and forfeiture rates are considered separately for valuation and attribution purposes.

Beginning in 2006, we began to use a lattice model to value options that vest upon the earlier of the achievement of a service condition or the achievement of a market condition. Options with these vesting terms have been granted to one of our executives. In addition to these assumptions used under the Black-Scholes model, the lattice model requires inputs for post-vesting turnover rate and suboptimal exercise factor. The post-vesting forfeiture rate is 0% based on the historically low option cancellation rates of our executive employees. The suboptimal exercise factor, which is the ratio by which the stock price must increase before an employee is expected to exercise the option, is 1.7 based on actual historical exercise activity. The expected life of the option is an output of the lattice model and has ranged between 6 and 7 years during 2006.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2005	2006	2005	2006
Risk-free interest rate option plan grants	3.77% 3.93%	4.92% 5.11%	3.44% 3.98%	4.29% 5.20%
Risk-free interest rate purchase plan grants	3.35%	5.25%	2.55% 3.35%	4.37% 5.25%
Dividend yield	0%	0%	0%	0%
Expected life of option grants	3 years	4 6 years	3 years	3 10 years
Expected life of stock purchase plan grants	0.5 years	0.5 years	0.5 years	0.5 years
Stock price volatility option plan grants	49.7% 49.9%	46.5% 50.3%	49.7% 54.1%	45.7% 51.7%
Stock price volatility purchase plan grants	23.2%	37.7%	23.2% 34.7%	32.0% 37.7%

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FTI Consulting, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (continued)

(amounts in tables expressed in thousands, except per share data)

Unaudited

The table below reflects the total share-based compensation expense recognized in our statements of operations for the three and nine months ended September 30, 2005 and 2006. Statement No. 123(R) requires forfeitures to be estimated at the time an award is granted and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Pre-vesting forfeitures were estimated to be between 0% and 3% based on historical experience. For the three and nine months ended September 30, 2006, share-based compensation expense is based on awards ultimately expected to vest and has been reduced for estimated forfeitures. In our pro forma disclosures of share-based compensation under Statement No. 123, we accounted for forfeitures as they occurred.

	2005		2006	
Statement of Operations Classification	**Option Grants and Stock Purchase Plan Rights**	**Restricted Stock Grants**	**Option Grants and Stock Purchase Plan Rights**	**Restricted Stock Grants**
Three Months Ending September 30				
Direct cost of revenues	$	$ 324	$ 1,134	$ 215
Selling, general and administrative expense		144	1,675	429
Special charges			18	566
Share-based compensation expense before income taxes		468	2,827	1,210
Income tax benefit		196	863	516
Share-based compensation, net of income taxes	$	$ 272	$ 1,964	$ 694
Nine Months Ending September 30				
Direct cost of revenues	$	$ 972	$ 2,407	$ 841
Selling, general and administrative expense		402	5,848	1,028
Special charges			18	566
Share-based compensation expense before income taxes		1,374	8,273	2,435
Income tax benefit		577	2,100	1,038
Share-based compensation, net of income taxes	$	$ 797	$ 6,173	$ 1,397

As of September 30, 2006, there was $17.9 million of unrecognized compensation cost related to unvested stock options, net of forfeitures. That cost is expected to be recognized ratably over a weighted-average period of 3.8 years as the options vest. There were no share-based compensation costs capitalized as of September 30, 2006.

As permitted by Statement No. 123, prior to January 1, 2006, we accounted for share-based payments to employees and non-employee members of our board of directors using the intrinsic value method prescribed by APB Opinion No. 25. Under APB Opinion No. 25, we recorded

compensation expense over the vesting period to the extent that the fair value of the underlying shares of common stock on the grant date exceeded the exercise or acquisition price of the stock or share-based award. Because options granted under our share-based incentive compensation plans had an exercise price greater than or equal to the market value of the underlying common stock on the grant date, we generally did not recognize compensation cost related to stock options or shares issued under our employee stock purchase plan. For the three and nine months ending September 30, 2005, the following table

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Notes to Condensed Consolidated Financial Statements (continued)

(amounts in tables expressed in thousands, except per share data)

Unaudited

illustrates the effect on net income and earnings per share if we had determined compensation cost by applying the fair value recognition provisions of Statement No. 123 to share-based employee awards.

	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Net income, as reported	$ 11,203	$ 38,067
Add Share-based employee compensation cost included in reported net income, net of income taxes	272	797
Deduct Total share-based employee compensation expense determined under a fair value based method for all awards, net of income taxes	(1,733)	(5,827)
Net income, pro forma	$ 9,742	$ 33,037
Earnings per common share		
Basic, as reported	$ 0.28	$ 0.91
Basic, pro forma	$ 0.24	$ 0.79
Diluted, as reported	$ 0.27	$ 0.90
Diluted, pro forma	$ 0.24	$ 0.78

General Stock Option and Share-Based Award Information. The following table summarizes the option activity under our share-based incentive compensation plans as of and during the nine months ended September 30, 2006. The aggregate intrinsic value in the table below represents the total pre-tax intrinsic value (the difference between the closing price of our common stock on the last trading day of the third quarter of 2006 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on September 30, 2006. This amount changes based on changes in the fair market value of our common stock.

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Options outstanding, January 1, 2006	4,604	$ 20.56		
Options granted during the period:				
Exercise Price = fair market value	1,247	$ 27.21		

Exercise Price > fair market value	68	$	29.16		
Options exercised	(363)	$	17.74		
Options forfeited	(141)	$	22.11		
Options outstanding, September 30, 2006	5,415	$	22.35	7.4 years	$ 19,503
Options exercisable, September 30, 2006	3,182	$	20.70	6.3 years	$ 15,019

The intrinsic value of options exercised is the amount by which the market value of our common stock on the exercise date exceeds the exercise price. The total intrinsic value of options exercised was:

$2.8 million during the three months ended September 30, 2005;

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$0.5 million during the three months ended September 30, 2006;

$3.1 million during the nine months ended September 30, 2005; and

$3.0 million during the nine months ended September 30, 2006.

The table below reflects the weighted-average grant-date fair value of stock options granted, shares purchased under our employee stock purchase plan and restricted shares granted during the three and nine months ended September 30, 2005 and 2006.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2005	2006	2005	2006
Stock options:				
Exercise price = fair market value	$ 7.76	$ 12.14	$ 7.95	$ 14.52
Exercise price > fair market value	$ 8.17	$ 8.76	$ 7.48	$ 10.34
Employee stock purchase plan shares	$ 4.63	$ 7.06	$ 5.10	$ 6.86
Restricted awards		$ 24.04	$ 22.34	$ 26.45

Following is a summary of the status of stock options outstanding and exercisable at September 30, 2006.

		Options Outstanding			Options Exercisable	
Exercise Price Range		Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Shares	Weighted-Average Exercise Price
$ 1.90	$19.00	1,196	$14.87	6.5 years	811	$ 12.83
$19.09	$21.65	1,201	$20.74	6.8 years	992	$ 20.97
$21.70	$25.67	1,083	$23.67	6.8 years	880	$ 23.90
$25.73	$27.60	1,198	$26.86	8.3 years	474	$ 27.27
$27.90	$33.25	737	$28.63	9.0 years	25	$ 28.09
		5,415			3,182	

A summary of our unvested restricted share award activity during the nine months ended September 30, 2006 is presented below. The fair value of unvested restricted share-based awards is determined based on the closing market price of our common stock on the grant date. Pre-vesting forfeitures were estimated to be between 0% and 1% based on historical experience.

	Shares	Weighted-Average Grant-Date Fair Value
Unvested restricted shares outstanding, January 1	640	$ 21.32
Restricted share awards granted	157	$ 26.45
Restricted share awards vested	(92)	$ 20.43
Restricted share awards forfeited	(35)	$ 21.15
Unvested restricted shares outstanding, September 30	670	$ 22.65

As of September 30, 2006, there was $12.4 million of unrecognized compensation cost related to unvested restricted share-based compensation arrangements. That cost is expected to be recognized ratably over a weighted-average period of 3.7 years as the awards vest. The total fair value of restricted share-based awards that

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vested was $1.5 million during the three months ended September 30, 2006 and $1.9 million during the nine months ended September 30, 2006. The total fair value of restricted share-based awards that vested during the three and nine months ended September 30, 2005 was $0.3 million.

3. Acquisitions

We record assets acquired and liabilities assumed in business combinations on our balance sheet as of the respective acquisition dates based upon their estimated fair values at the acquisition date. We include the results of operations of businesses acquired in our Statement of operations beginning on the acquisition dates. We allocate the acquisition cost to identifiable tangible and intangible assets and liabilities based upon their estimated relative fair values. We allocate the excess of the purchase price over the estimated fair values of the underlying assets acquired and liabilities assumed to goodwill. We determine the fair value of intangible assets acquired based upon independent appraisals. The fair value of shares of our common stock issued in connection with a business combination is based on a five-day average of the closing price of our common stock two days before and two days after the date we agree to the terms of the acquisition and publicly announce the transaction. In certain circumstances, the allocations of the excess purchase price are based on preliminary estimates and assumptions. Accordingly, the allocations are subject to revision when we receive final information, including appraisals and other analyses. Revisions to our preliminary estimates of fair value may be significant. Since the business combinations consummated in 2005 and 2006 did not materially impact our results of operations, pro forma results have not been presented.

Compass. On January 6, 2006, we completed our acquisition of Competition Policy Associates, Inc., or Compass. Compass is a competition economics consulting firm, with offices in Washington, D.C. and San Francisco. Compass provides services that involve sophisticated economic analysis in the context of antitrust disputes, mergers and acquisitions, regulatory and policy debates, and general commercial litigation across a broad range of industries in the United States, Europe and the Pacific Rim. The total acquisition cost, net of post-closing adjustments, was $73.4 million consisting of net cash of $46.9 million, $0.4 million of transaction costs and 909,346 restricted shares of common stock valued at $26.1 million. We financed the cash portion of the purchase price from cash on hand. For each fiscal year ending between December 31, 2006 and December 31, 2013, the purchase agreement provides for:

- additional consideration based on earnings before interest and taxes, or EBIT of the business unit (as defined in the purchase agreement);
- the set aside of a percentage of EBIT of the business unit for each fiscal year to be used as incentive compensation to employees of and consultants to the business; and
- conditional contractual protection against a decline in the value of the shares of our common stock issued as purchase price below the issuance price of $27.61.

The identifiable intangible assets we acquired consist principally of contract backlog, customer relationships, non-competition agreements and tradename and total $16.4 million. We recorded $52.7 million of goodwill as a result of the value of the assembled workforce we acquired and the ability to earn a higher rate of return from the acquired business than would be expected if those net assets had to be acquired or developed separately. We believe the goodwill recorded as a result of this acquisition will be fully deductible for income tax purposes over the next 15 years.

We issued an aggregate of $8.0 million of loans to key employees and outside consultants of Compass at the time of the acquisition. Interest is payable quarterly at 4.65%. The principal amount is due in January 2016 or earlier if the employee resigns, the consultant stops providing service to us or other events of default occur. These loans are classified as long-term notes receivable in our consolidated balance sheet.

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Other. During the third quarter of 2006, we completed two business combinations. The total acquisition cost was $23.5 million, consisting of net cash of $19.5 million and 155,434 restricted shares of our common stock valued at $4.0 million. The purchase agreements for these business combinations contain provisions that include additional cash payments based on the achievement of annual financial targets in each of the next five to six years. Any contingent consideration payable in the future will be applied to goodwill.

4. Goodwill and Other Intangible Assets

The changes in the carrying amounts of goodwill for the three and nine months ended September 30, 2006, are as follows:

	Corporate Finance/ Restructuring	Forensic/ Litigation	Economics	Technology	Total Company
Balance, January 1, 2006	$ 298,839	$ 122,140	$ 125,349	$ 30,284	$ 576,612
Goodwill acquired during the period		18,149	52,740		70,889
Adjustments to allocation of purchase price	(268)	2		82	(184)
Balance, September 30, 2006	$ 298,571	$ 140,291	$ 178,089	$ 30,366	$ 647,317

Other intangible assets with finite lives are amortized over their estimated useful lives. During the third quarter of 2006, we determined that the backlog we acquired in May 2005 in connection with our acquisition of Cambio Health Solutions had a shorter life than we originally estimated and therefore, we recorded a $0.9 million non-cash intangible impairment charge. This amount is recorded as a special charge in our statement of operations. For intangible assets with finite lives, we recorded amortization expense of $4.3 million for the nine months ended September 30, 2005 and $8.3 million for the nine months ended September 30, 2006. Based solely on the amortizable intangible assets recorded as of September 30, 2006, we estimate amortization expense to be $2.0 million during the remainder of 2006, $6.3 million in 2007, $4.1 million in 2008, $3.9 million in 2009, $2.1 million in 2010, $1.8 million in 2011, and $5.4 million in years after 2011. Actual amortization expense to be reported in future periods could differ from these estimates as a result of new intangible asset acquisitions, changes in useful lives or other relevant factors. The carrying amounts of the amortizable assets we acquired in connection with the acquisitions completed during the third quarter of 2006 are based on our estimated valuations, which we expect to complete by the end of 2006. The final purchase price allocations may differ from our preliminary estimates. See note 3.

		December 31, 2005		September 30, 2006	
	Useful Life in Years	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets					
Customer relationships	3 to 15	$ 10,340	$ 2,827	$ 17,744	$ 4,523
Contract backlog	0.5 to 3	8,105	3,536	5,826	2,737
Software	5	4,400	733	4,400	1,393
Non-competition agreements	3 to 5	2,421	1,116	8,228	1,967

		25,266	8,212	36,198	10,620
Unamortized intangible assets					
Tradenames	Indefinite	4,400		7,864	
		$ 29,666	$ 8,212	$ 44,062	$ 10,620

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5. Long-Term Debt and Capital Lease Obligations

	December 31, 2005	September 30, 2006
7 5/8% senior notes due 2013, including a fair value hedge adjustment of $1,569 2005 and $1,982 2006	$ 198,431	$ 198,018
3 3/4% convertible senior subordinated notes due 2012	150,000	150,000
Other		385
Total long-term debt	348,431	348,403
Less current portion		42
Long-term debt, net of current portion	$ 348,431	$ 348,361
Total capital lease obligations	$ 98	$ 37
Less current portion	76	37
Capital lease obligations, net of current portion	$ 22	$

Senior Secured Credit Facility. On September 29, 2006, we amended and restated our senior secured credit facility to provide for $50.0 million in additional borrowing capacity under our revolving line of credit, accommodate the offering of our 7 3/4% senior notes described below in note 10, adjust our financial covenants and effect certain other changes. As of September 30, 2006, our senior secured credit facility provides for a $150.0 million revolving line of credit. The maturity date of the $150.0 million revolving line of credit is September 30, 2011. We may choose to repay outstanding borrowings under the senior secured credit facility at any time before maturity without penalty. Debt under the senior secured credit facility bears interest at an annual rate equal to the Eurodollar rate plus an applicable margin or an alternative base rate defined as the higher of (1) the lender s announced U.S. prime rate or (2) the federal funds rate plus the sum of 50 basis points and an applicable margin. We are also required to pay a commitment fee of between 0.25% and 0.5% on the unused portion of the revolving line of credit which is subject to change based on our consolidated leverage ratio. As of September 30, 2006, our commitment fee rate was 0.375%. Under the senior secured credit facility, the lenders have a security interest in substantially all of our assets. As of September 30, 2006, we had no borrowings outstanding under our revolving line of credit. The availability of borrowings under our revolving line of credit is subject to specified borrowing conditions. We use letters of credit primarily as security deposits for our office facilities. Letters of credit reduce the availability under our revolving line of credit. As of September 30, 2006, we had $9.6 million of outstanding letters of credit, which reduced the available borrowings under our revolving line of credit to $140.4 million.

Our senior secured credit facility and the indenture governing our senior notes contain covenants which limit our ability to incur additional indebtedness; create liens; pay dividends on, make distributions or repurchases of our capital stock or make specified other restricted payments; consolidate, merge or sell all or substantially all of our assets; guarantee obligations of other entities; enter into hedging agreements; enter into transactions with affiliates or related persons or engage in any business other than the consulting business. The senior secured credit facility requires compliance with financial ratios, including total indebtedness to earnings before interest, taxes, depreciation and amortization, or EBITDA; EBITDA to specified charges and the maintenance of a minimum net worth, each as defined under the senior secured credit facility. At September 30, 2006, there were no events of default under the covenants in the senior secured credit facility and the indentures governing our senior and convertible notes.

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Guarantees. Currently, we do not have any significant debt guarantees related to entities outside of the consolidated group. As of September 30, 2006, substantially all of our domestic subsidiaries are guarantors of borrowings under our senior secured credit facility, our senior notes and our convertible notes in the amount of $350.0 million. We directly own 100% of each subsidiary guarantor. The guarantees are full and unconditional and joint and several, and the non-guarantor subsidiaries are minor. There are no significant restrictions on our ability or the ability of any guarantor to obtain funds from our subsidiaries by dividend or loan.

Future Maturities of Long-Term Debt and Capital Lease Obligations. For periods subsequent to September 30, 2006, scheduled annual maturities of long-term debt and capital lease obligations outstanding as of September 30, 2006 are as follows.

	Long-Term Debt	Capital Lease Obligations	Total
September 1 to December 31, 2006	$ 10	$ 38	$ 48
2007	44		44
2008	45		45
2009	45		45
2010	46		46
2011	47		47
Thereafter	350,148		350,148
	350,385	38	350,423
Less fair value hedge adjustment	1,982		1,982
Less imputed interest		1	1
	$ 348,403	$ 37	$ 348,440

6. Derivative Instruments and Hedging Activities

We use derivative instruments, consisting primarily of interest rate swap agreements, to manage our exposure to changes in the fair values or future cash flows of some of our long-term debt which are caused by interest rate fluctuations. We do not use derivative instruments for trading or other speculative purposes. The use of derivative instruments exposes us to market risk and credit risk. Market risk is the adverse effect that a change in interest rates has on the value of a financial instrument. While derivative instruments are subject to fluctuations in values, these fluctuations are generally offset by fluctuations in fair values or cash flows of the underlying hedged items. Credit risk is the risk that the counterparty exposes us to loss in the event of non-performance. We enter into derivative financial instruments with high credit quality counterparties and diversify our positions among such counterparties in order to reduce our exposure to credit losses.

From time to time, we hedge the cash flows and fair values of some of our long-term debt using interest rate swaps. We enter into these derivative contracts to manage our exposure to interest rate changes by achieving a desired proportion of fixed rate versus variable rate debt. In an interest rate swap, we agree to exchange the difference between a variable interest rate and either a fixed or another variable interest rate multiplied by a notional principal amount. We record all interest rate swaps at their fair market values within other assets or other liabilities on our balance sheet. As of December 31, 2005, the fair value of our interest rate swap agreement was a liability of $1.6 million. As of September 30, 2006, the fair value of our interest rate swap agreement was a liability of $2.0 million.

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In August 2005, we entered into two interest rate swap agreements to hedge the risk of changes in the fair value of a portion of our 7 5/8% fixed rate senior notes. The interest swap agreements mature on September 15, 2013. Under the terms of the interest rate swap agreements, we receive interest on the $60.0 million notional amount at a fixed rate of 7.625% and pay a variable rate of interest, between 8.21% and 8.25% at September 30, 2006, based on the London Interbank Offered Rate, or LIBOR, as the benchmark interest rate. The maturity, payment dates and other critical terms of these swaps exactly match those of the hedged senior notes. In accordance with Statement of Financial Accounting Standard No. 133, Accounting for Derivative Instruments and Hedging Activities, the swaps are accounted for as effective hedges. Accordingly, the changes in the fair values of both the swaps and the debt are recorded as equal and offsetting gains and losses in interest expense. No hedge ineffectiveness has been recognized as the critical provisions of the interest rate swap agreements match the applicable provisions of the debt. The impact of effectively converting the interest rate of $60.0 million of our senior notes from fixed rate to variable rate increased interest expense by $115,000 for the three months ended September 30, 2006 and by $152,000 for the nine months ended September 30, 2006.

7. Commitments and Contingencies

Loss on Subleased Facilities. During the fourth quarter of 2004, we consolidated our New York City and Saddle Brook, New Jersey offices and relocated our employees into our new office facility. As a result of this decision, we vacated leased office facilities prior to the lease termination dates. We recorded a loss of $4.7 million within our corporate segment related to the abandoned facilities during the fourth quarter of 2004. This charge includes $0.7 million of asset impairments and $4.0 million representing the present value of the future lease payments related to the facilities we vacated net of estimated sublease income of $4.2 million. In August 2005, we entered into a 30-month sublease related to some space in our new office facility in New York City resulting in a loss of $0.9 million. Sublease losses are classified as a component of selling, general and administrative expense and primarily represent the present value of the future lease payments related to the space we subleased net of estimated sublease income. As of December 31, 2005, the balance of the liability for loss on abandoned and subleased facilities was $2.4 million. During 2006, we made payments, net of sublease income, of about $0.5 million against the total lease loss liability. As of September 30, 2006, the balance of the liability for losses on abandoned and subleased facilities was $1.9 million.

Special Charges. During the third quarter of 2006, we recorded special charges totaling $23.0 million. The charges reflect actions we took to address certain underperforming operations. In particular, we restructured our corporate finance U.K. operations and consolidated certain of our non-core practices in the United States, primarily through reductions in workforce. The charges consist of

- $22.1 million of severance and other contractual employee related costs associated with the reduction in workforce, including $0.6 million related to the accelerated vesting of share-based awards; and

- a $0.9 million non-cash intangible impairment charge associated with the contract backlog we acquired in May 2005 in connection with our acquisition of Cambio Health Solutions. See note 4.

We expect to make cash payments in connection with the reduction in workforce during the remainder of 2006 and continuing through 2008.

Contingencies. We are subject to legal actions arising in the ordinary course of business. In management s opinion, we believe we have adequate legal defenses and/or insurance coverage with respect to the eventuality of such actions. We do not believe any settlement or judgment would materially affect our financial position or results of operations.

See Part II Other Information, Item 1. Legal Proceedings.

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8. Stockholders Equity

Common Stock Repurchase Program. In October 2003, our board of directors authorized the purchase, from time to time, of up to $50.0 million of our common stock. Since then, the authorized amount has been increased to a total of $219.7 million. Our share repurchase program is effective through December 31, 2006. The shares of common stock may be purchased through open market or privately negotiated transactions and will be funded with a combination of cash on hand, existing bank credit facilities or new credit facilities.

On July 28, 2005, we entered into an accelerated share repurchase agreement with an investment bank in connection with our convertible notes offering. Under that agreement, we purchased and retired 2.3 million shares of our common stock from the investment bank for an aggregate purchase price of $55.1 million, representing an initial purchase price of $24.04 per share plus transaction costs. The share purchase was funded using the proceeds received from the private placement of our convertible notes. We recorded the stock purchase as a reduction to stockholders equity.

As part of the accelerated share repurchase transaction, we simultaneously entered into a forward contract with the investment bank that matured on February 10, 2006. The objective of the forward contract was to minimize the impact on our share price volatility of the large repurchase of shares of our common stock on July 28, 2005. The investment bank borrowed the shares of common stock that were sold to us and replaced the borrowed shares with shares repurchased on the open market in smaller ratable purchases over the term of the forward contract thereby minimizing the market impact of the large block share repurchase. Under the terms of the forward contract, the investment bank purchased, in the open market, 2.3 million shares of our common stock during the term of the contract in order to fulfill its obligation related to the shares it borrowed from third parties and sold to us. On February 10, 2006, the investment bank had completed its acquisition of 2.3 million shares of our common stock at an average price of $27.03 per share. Upon the conclusion of the agreement, we were required to make a settlement payment of $6.8 million, which we elected to pay in cash.

We accounted for the forward contract under the provisions of EITF Issue No. 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock, as an equity instrument. As the fair value of the forward contract at inception was zero, no accounting for the forward contract was required until settlement, since the forward contract continued to meet the requirements for classification as an equity instrument. The amount paid to settle the contract was recorded as a reduction to additional paid-in capital and reflected as a purchase of common stock within our statement of stockholders equity.

During the nine months ended September 30, 2006, we purchased and retired 0.6 million shares of our common stock for a total cost of about $16.6 million. Since inception of the program, we purchased and retired a total of 7.6 million shares of our common stock for a total of $186.2 million, including the $6.8 million we paid to settle the accelerated share repurchase agreement in February 2006, leaving $33.5 million available for purchase under the program.

9. Segment Reporting

We manage our business in four reportable operating segments. Our reportable operating segments are managed separately and include our forensic/litigation practice, our corporate finance/restructuring practice, our economic consulting practice and our technology practice. We began to manage our technology practice as a separate reportable operating segment beginning in January 2006. This operating segment was previously managed within our forensic/litigation practice. Our technology consulting segment consists of our electronic

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evidence and e-discovery practice group, the complex litigation data analysis practice group, the software development group and our application services provider and document analytics business. We have presented estimated 2005 segment results to compare to our 2006 presentation in the table below. However, if our technology practice had been managed as a separate segment during 2005, our actual results may have differed significantly as items such as direct bonuses and allocations of selling, general and administrative expenses may have been computed differently.

We evaluate the performance of our operating segments based on income before income taxes, net interest expense, depreciation, amortization, special charges and corporate selling, general and administrative expenses, which we refer to as segment profits. In general, our total assets, including long-lived assets such as property and equipment, and our capital expenditures are not specifically allocated to any particular segment. Accordingly, capital expenditures and total asset information by reportable segment is not presented. The reportable segments use the same accounting policies as those used by the company. There are no significant intercompany sales or transfers.

Substantially all of our revenues and assets are attributed to or are located in the United States. We do not have a single customer that represents ten percent or more of our consolidated revenues.

	Forensic/ Litigation	Corporate Finance/ Restructuring	Economic Consulting	Technology	Corporate	Total
Three Months Ended September 30, 2005						
Revenues	$ 38,096	$ 49,605	$ 28,387	$ 17,101	$	$ 133,189
Gross margin	17,002	22,538	10,715	9,593		59,848
Segment profit (loss)	9,564	14,084	7,211	7,222	(7,803)	30,278
Three Months Ended September 30, 2006						
Revenues	$ 46,833	$ 50,725	$ 34,554	$ 29,956	$	$ 162,068
Gross margin	21,910	20,375	12,386	15,843		70,514
Segment profit (loss)	13,352	12,026	7,631	11,346	(9,644)	34,711
Nine Months Ended September 30, 2005						
Revenues	$ 114,740	$ 135,441	$ 81,355	$ 42,184	$	$ 373,720
Gross margin	54,088	63,809	30,226	22,719		170,842
Segment profit (loss)	33,862	41,281	19,880	16,782	(23,676)	88,129
Nine Months Ended September 30, 2006						
Revenues	$ 142,058	$ 154,729	$ 108,257	$ 86,048	$	$ 491,092
Gross margin	64,976	61,650	39,673	47,897		214,196
Segment profit (loss)	39,702	36,412	25,877	34,270	(33,799)	102,462

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The following table presents a reconciliation of segment profit to income before income tax provision.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	**2006**	**2005**	**2006**
Operating profit				
Total segment profit	$ 30,278	$ 34,711	$ 88,129	$ 102,462
Special charges		(22,972)		(22,972)
Depreciation and amortization	(2,996)	(3,220)	(8,308)	(9,394)
Amortization of other intangible assets	(1,952)	(2,551)	(4,309)	(8,310)
Interest and other expense, net	(6,014)	(5,692)	(9,879)	(16,105)
Income before income tax provision	$ 19,316	$ 276	$ 65,633	$ 45,681

For the three and nine months ended September 30, 2006, the detail of the special charges by segment is as follows:

Forensic/Litigation	$ 9,890
Corporate Finance/Restructuring	7,740
Economic Consulting	4,148
Technology	
Corporate	1,194
Total Company	$ 22,972

10. Subsequent Events

7 3/4% Senior Notes due 2016. On October 3, 2006, we completed the issuance and sale in a private placement of $215.0 million in principal amount of 7 3/4% senior notes due October 1, 2016, generating net cash proceeds of $207.5 million after deducting fees and expenses and the initial purchasers discounts. Cash interest is payable semiannually beginning April 1, 2007 at a rate of 7.75% per year. We may choose to redeem some or all of these notes starting October 1, 2011 at an initial redemption price of 103.875% of the aggregate principal amount of these notes plus accrued and unpaid interest. On or before October 1, 2009, we may choose to redeem up to 35% of the original principal amount of the notes using the proceeds of one or more sales of qualified equity securities at 107.75% of their principal amount, plus accrued and unpaid interest to the date of redemption. These notes are senior unsecured indebtedness of ours and rank equal in right of payment with all of our other unsubordinated, unsecured indebtedness. We have agreed to specific registration rights with respect to these notes. If an exchange offer of new notes, without restrictive transfer legends, for these notes is not consummated by May 1, 2007, and we do not maintain the registration of the notes effective through maturity, subject to limitations, then the annual interest rate on these notes will increase by 0.25% every 90 days, up to a maximum of 1.0%, until the default ceases to exist. If we have a registration default and subsequently correct it, the annual interest rate on the notes will revert to 7.75%.

Financial Dynamics. On October 4, 2006, we completed our acquisition of 97% of the share capital of FD International (Holdings) Limited, or FD, a global strategic business and financial communications consulting firm headquartered in London. FD provides consulting services related to financial communications, brand communications, public affairs and issues management and strategy development. The total acquisition cost was about $270 million, including transaction costs. The acquisition cost consists of cash, about 1.1 million restricted shares of common stock, notes payable to the certain sellers, and deferred purchase obligations. We funded the cash portion of the purchase price through the issuance of our 7 3/4% senior notes and borrowings of $40.0 million under our amended and restated senior bank credit facility.

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

Introduction and Overview

The following is a discussion and analysis of our consolidated financial condition and results of operations for the three- and nine-month periods ended September 30, 2006 and 2005, and significant factors that could affect our prospective financial condition and results of operations. You should read this discussion together with the accompanying unaudited condensed consolidated financial statements and notes and with our annual report on Form 10-K for the year ended December 31, 2005. Historical results and any discussion of prospective results may not indicate our future performance. See Forward Looking Statements.

We are a leading global firm that organizations rely on when confronting the critical legal, financial and reputational issues that shape their futures. We provide advice and solutions to major corporations, financial institutions and law firms in the areas of forensic analysis, investigation, economic analysis, restructuring, due diligence, strategic communication, financial communication and technology.

Through our forensic/litigation practice, we provide an extensive range of services to assist clients in all phases of litigation, including pre-filing, discovery, jury selection, trial preparation, expert testimony and other trial support services. Specifically, we help clients assess complex financial transactions, reconstruct events from incomplete and/or corrupt data, uncover vital evidence, identify potential claims and assist in the pursuit of financial recoveries and settlements. Through the use of proprietary information technology, we have demonstrated our ability to help control litigation costs, expedite the trial process and provide our clients with the ability to readily organize and access case-related data. Our graphics services at trial and technology and electronic evidence experts assist clients in preparing for and presenting their cases in court.

Beginning in January 2006, we began to manage our technology practice as a separate reportable operating segment. Our technology consulting segment consists of our electronic evidence and e-discovery practice group, the complex litigation data analysis practice group, the software development group and our application services provider and document analytics business. Our repository services offer clients a secure extranet and web-hosting service for critical information. Previously, our technology practice was managed within our forensic/litigation practice. We have presented estimated 2005 segment results to compare to our 2006 presentation. However, if our technology practice had been managed as a separate segment during 2005, our actual results may have differed significantly as items such as direct bonuses and allocations of selling, general and administrative expenses may have been computed differently.

Our corporate finance/restructuring practice assists underperforming companies as they make decisions to improve their financial condition and operations. We analyze, recommend and implement strategic alternatives for our corporate finance/restructuring clients, such as interim management in turnaround situations, rightsizing infrastructure, assessing long-term viability, transaction advisory and business strategy consulting. We lead and manage the financial aspects of in-court restructuring processes by offering services that include an assessment of the impact of a bankruptcy filing on the client s financial condition and operations. We also assist our clients in planning for a smooth transition into and out of bankruptcy, facilitating the sale of assets and arranging debtor-in-possession financing.

Through our economic consulting practice, we deliver sophisticated economic analysis and modeling of issues arising in mergers and acquisitions and other complex commercial and securities litigation. Our services include providing advice and testimony related to:

- antitrust and competition issues that arise in the context of potential mergers and acquisitions;
- other antitrust issues, including alleged price fixing, cartels and other forms of exclusionary behavior;
- the application of modern finance theory to issues arising in securities litigation; and
- public policy studies on behalf of companies, trade associations and governmental agencies.

Our statistical and economic experts help companies evaluate issues such as the economic impact of deregulation on a particular industry or the amount of commercial damages suffered by a business. We have deep industry experience in such areas as commercial and investment banking, telecommunications, energy, transportation, healthcare and pharmaceuticals. Our professionals have experience providing testimony in the following areas: fraud, damages, lost profits, valuation, accountant s liability and malpractice, contract disputes, patent infringement, price fixing, purchase price disputes, solvency and insolvency, fraudulent conveyance, preferences, disclosure statements, trademark and copyright infringement and the financial impact of government regulations.

We will manage our recently completed acquisition of FD International (Holdings) Limited as our strategic communications consulting segment. Through our strategic communications practice, we provide advice and consulting related to financial communications, brand communications, public affairs and issues management and business consulting. Our financial communications service offerings include strategic boardroom advice, financial calendar support, mergers and acquisitions transactions, investor relations, financial and business media relations, capital market intelligence, initial public offerings, debt markets, corporate restructuring, proxy solicitation, corporate governance, corporate social responsibility advice and regulatory communications.

The brand communications practice provides creative services to build consumer and business-to-business brands. Its communication service offerings include strategic marketing advice, business-to-business marketing consultancy, media relations, brand consultancy and repositioning, qualitative and quantitative research, sponsorship consultancy, thought leadership consultancy, launch and event management, strategy and event management and consumer communications.

The public affairs and issues management practice helps to shape messages to policymakers and respond to crisis situations. The services of public affairs include political intelligence, policy formation, political and media campaigns, third party and coalition mobilization, state aid, monopoly and anti-trust regulatory affairs. The services of issues management include business continuity planning, crisis communications planning, crisis handling, media relations, reputation rehabilitation and simulation exercises.

The business consulting practice has dedicated teams providing strategic advice and solving business problems by utilizing world-class research and methodologies. The consulting services offered include corporate strategy, growth strategy, cost management, mergers and acquisitions, organization, performance improvement, private equity and revenue enhancement.

Recent Events Affecting Our Operations. Effective January 1, 2006, we adopted Statement No. 123(R) using the modified prospective transition method under which prior period amounts are not restated for comparative purposes. In 2006, we began to recognize expense in our statement of operations associated with all share-based awards based on the grant-date fair value of the awards. As a result of adopting Statement No. 123(R), our results of operations are different than they would have been if we had continued to account for share-based compensation under APB Opinion No. 25. If we had continued to account for share-based compensation under APB Opinion No. 25:

- for the three months ended September 30, 2006,
  - our income before income taxes would have been $2.8 million higher;
  - our net income would have been $2.0 million higher;
  - our basic earnings per share would have been $0.05 higher than our reported basic loss per share of $0.01; and
  - our diluted earnings per share would have been $0.05 higher than our reported diluted loss per share of $0.01; and
- for the nine months ended September 30, 2006,

our income before income taxes would have been $8.3 million higher;

- our net income would have been $6.2 million higher;
- our basic earnings per share would have been $0.15 higher than our reported basic earnings per share of $0.63; and
- our diluted earnings per share would have been $0.15 higher than our reported diluted earnings per share of $0.61.

As of September 30, 2006, there was $17.9 million of unrecognized compensation cost related to unvested stock options, net of forfeitures. That cost is expected to be recognized ratably over a weighted-average period of 3.8 years as the options vest. See note 2 to our consolidated financial statements for more detailed information.

On January 6, 2006, we completed our acquisition of Competition Policy Associates, Inc., or Compass. The total acquisition cost, net of post-closing adjustments, was about $73.4 million consisting of net cash of $46.9 million, $0.4 million of transaction costs and 909,346 restricted shares of common stock valued at $26.1 million. Compass is a top competition economics consulting firm, with offices in Washington, D.C. and San Francisco. Compass provides services that involve sophisticated economic analysis in the context of antitrust disputes, mergers and acquisitions, regulatory and policy debates, and general commercial litigation across a broad range of industries in the United States, Europe and the Pacific Rim. Compass operates as part of our economic consulting group.

Through September 30, 2006, we have entered into employment arrangements with 28 senior managing directors in our corporate finance practice. Most of these professionals signed employment agreements that cover an initial term of five years and include automatic one-year renewal options. The agreements provide for fixed salary and participation in compensation payment plans (for the practice group, including incentive awards based on financial measures such as earnings before interest, income taxes, depreciation of property and equipment and amortization of other intangible assets, or EBITDA.) The employment agreements also provide for initial and periodic equity incentives in the form of stock options or restricted share-based awards. The initial grants of equity incentive awards generally vest over a six-year period. Periodic equity awards will in most cases vest over periods ranging from three to five years. In lieu of paying cash signing bonuses, we also extended unsecured general recourse forgivable loans to professionals, provided they were not executive officers. All or a portion of the loans may be forgiven in certain circumstances after the fifth year of service. We believe the loan arrangements enhance our ability to attract and retain senior professionals. The forgivable loans require repayment in full prior to the fifth year of service if the employee s employment terminates, based on certain events specified in the agreement. If the employee s employment terminates after the fifth year of service all or a portion of the principal amount of the loan and accrued interest could be forgiven. In connection with the agreements we entered into during the nine months ended September 30, 2006,

- we issued stock options to purchase a total of 670,000 shares of common stock at exercise prices equal to the fair market value of our common stock in each case as of the date that was the later of the date of approval by our Compensation Committee or the effective date of the new employment agreement entered into by the employee;
- we issued 98,000 restricted share awards; and
- we funded $21.7 million of forgivable loans provided to senior managing directors in the corporate finance/restructuring practice who entered into new employment arrangements during the period.

During the nine months ended September 30, 2006, we issued forgivable loans and refundable signing bonuses totaling about $40 million.

Long-term employment agreements generally provide for salary continuation benefits, accrued bonuses, accelerated vesting of equity awards and other benefits beyond the termination date if the professional leaves our employ for certain reasons prior to the agreement s expiration date. The length and amount of payments we

make, following the termination or resignation of a professional who is a party to a long-term employment agreement, varies depending on whether the professional resigned or was terminated with cause or good reason, resigned or was terminated without cause or good reason, died or became disabled, retired or was terminated as a result of a change of control. Our employment agreements generally contain non-competition and non-solicitation covenants, which under various circumstances, may extend beyond the applicable expiration or termination date depending upon the reason for termination. Under the non-competition covenants, the professional generally agrees not to offer or perform consulting services of the type performed during his employment, directly, or indirectly through another person or entity, in competition with us, within specified geographic areas, subject, in some cases, to certain exceptions. Generally, the professional also agrees not to solicit business regarding any case, matter or client the professional worked on our behalf, or to solicit, hire, or influence the departure of any of our employees, consultants or independent contractors. Under the general terms of the long-term employment agreement, the professional also agrees to maintain the confidentiality of our proprietary information and affirm that we are the owners of copyrights, trade marks, patents and inventions developed during the course of employment.

As of July 1, 2006, we completed our acquisition of International Risk Limited which is headquartered in Hong Kong. The total acquisition cost was about $12.0 million consisting of $9.0 million in cash and 114,618 restricted shares of common stock valued at $3.0 million. The purchase agreement also provides future contingent consideration based on specified financial objectives over the next 6 years. International Risk provides comprehensive business risk solutions including investigative due diligence services, fraud and corporate investigations, business intelligence, brand protection and intellectual property strategies, political risk assessments and crisis containment services. International Risk provides services to clients in Asia, Europe and the United States and operates as part of our forensic/litigation practice.

In September 2006, we completed our acquisition of Brower, Kriz & Stynchcomb, or BKS, a construction consulting firm based in Maryland specializing in critical path method schedule development, technical schedule review and progress evaluation. The total acquisition cost was about $11.5 million consisting of $10.5 million in cash and 40,816 restricted shares of common stock valued at $1.0 million. The purchase agreement also provides future contingent consideration based on specified financial objectives over the next 5 years. BKS operates as part of our forensic/litigation practice.

During the third quarter of 2006, we recorded special charges totaling $23.0 million. The charges reflect actions we took to address certain underperforming operations. In particular, we restructured our corporate finance U.K. operations and consolidated certain of our non-core practices in the United States, primarily through reductions in workforce. The charges consist of:

- $22.1 million of severance and other contractual employee related costs associated with the reduction in workforce, including $0.6 million related to the accelerated vesting of share-based awards; and

- a $0.9 million non-cash intangible impairment charge associated with the contract backlog we acquired in May 2005 in connection with our acquisition of Cambio Health Solutions.

These actions had the impact of reducing total headcount by 61, including 51 of our revenue-generating professionals. We reduced the number of revenue-generating professionals by 11 in our forensic/litigation practice, by 21 in our corporate finance/restructuring practice and by 19 in our economic consulting practice. We expect to make cash payments in connection with the reduction in workforce during the remainder of 2006 and continuing through 2008.

Transactions Affecting our Operations after September 30, 2006. On October 3, 2006, we completed the issuance and sale in a private placement of $215.0 million in principal amount of 7 3/4% senior notes due October 1, 2016, generating net cash proceeds of $207.5 million after deducting fees and expenses and the initial purchasers discounts. Cash interest is payable semiannually beginning April 1, 2007 at a rate of 7.75% per year.

On October 4, 2006, we completed our acquisition of 97% of the share capital of FD International (Holdings) Limited, or FD, a global strategic business and financial communications consulting firm headquartered in London. FD provides consulting services related to financial communications, brand communications, public affairs and issues management and strategy development. The total acquisition cost was

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about $270 million, including transaction costs. The acquisition cost consists of cash, about 1.1 million restricted shares of common stock, notes payable to the certain sellers, and deferred purchase obligations. We funded the cash portion of the purchase price through the issuance of our 7 3/4% senior notes and borrowings of $40.0 million under our amended and restated senior bank credit facility.

Financial and Operating Overview. Through September 30, 2006, we have generated substantially all of our revenues from providing professional services to our clients in the United States. Over the past several years the growth in our revenues and profitability has resulted from the acquisitions we have completed and from our ability to attract new and recurring engagements. As a result of our acquisition of FD, a larger percentage of our revenues will be generated from services we provide outside of the U.S.

Most of our services are rendered under time-and-expense arrangements that require the client to pay us a fee for the hours that we incur at agreed-upon rates. Under these arrangements we also bill our clients for reimbursable expenses which may include the cost of producing our work products and other direct expenses that we incur on behalf of the client, such as travel costs and materials that we purchase to produce presentations for courtroom proceedings. We also have performance-based engagements in which we earn a success fee when and if certain predefined outcomes occur. This type of success fee may supplement a time-and-expense or fixed-fee arrangement. Success fee revenues may cause significant variations in our revenues and operating results due to the timing of achieving the performance-based criteria.

During the three months ended September 30, 2006, our revenues increased $28.9 million, or 21.7%, as compared to the three months ended September 30, 2005. During the nine months ended September 30, 2006, our revenues increased $117.4 million, or 31.4%, as compared to the nine months ended September 30, 2005. Revenues increased in each of our operating segments for the three- and nine-month periods ended September 30, 2006 as compared to 2005. This growth is primarily attributable to an increase in the number of billable professionals we employ, improvements in the general economic conditions under which we operate and the acquisitions we completed during 2005 and 2006. See Results of Operations for a more detailed discussion and analysis of our financial results.

Our financial results are primarily driven by:

- the utilization rates of the billable professionals we employ;
- the number of revenue-generating professionals we employ;
- the rates per hour we charge our clients for service;
- the number and size of engagements we secure; and
- demand for our software products and other technology services.

Utilization Rates of Billable Professionals. We calculate the utilization rate for our professionals by dividing the number of hours that our professionals worked on client assignments during a period by the total available working hours for our professionals, assuming a 40-hour work week and a 52-week year. Available working hours include vacation and professional training days, but exclude holidays.

Utilization rates are presented below for each of our segments that primarily bill clients on an hourly basis. We have not presented a utilization rate for our technology segment as more than half of its revenues are not generated on an hourly basis.

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2005	2006	Percent Change	2005	2006	Percent Change

Forensic/Litigation	72%	73%	1.4%	76%	78%	2.6%
Corporate Finance/Restructuring	79%	73%	(7.6)%	82%	76%	(7.3)%
Economic Consulting	80%	76%	(5.0)%	84%	80%	(4.8)%

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Utilization of our professionals is affected by a number of factors, including:

- the number, size and timing of client engagements;
- the hiring of new professionals, which generally results in a temporary drop in our utilization rate during the transition period for new hires;
- our ability to forecast demand for our services and thereby maintain an appropriate level of professionals;
- the amount of services provided through engagements that are not billed on a time and expense basis;
- the timing of staff vacations; and
- conditions affecting the industries in which we practice as well as general economic conditions.

During the three- and nine-month periods ended September 30, 2006, our utilization rates decreased as compared to 2005 in our corporate finance/restructuring and economic consulting practices. The utilization of professionals in our corporate finance/restructuring practice decreased primarily due to a decrease in the number of bankruptcy cases in the United States which has caused a decline in demand for our restructuring and turnaround services. In addition, our corporate finance/restructuring group in the U.K. was underperforming and experienced low utilization rates. We took actions to reduce our workforce in the U.K. As a result, we expect utilization rates to improve in our corporate finance/restructuring practice. The utilization of professionals in our economic consulting practice decreased primarily due to an acquisition we completed on July 31, 2005. These professionals who provide strategy and brand consulting services have a lower utilization rate than we have historically experienced. In addition, demand for our economic consulting services was very high during 2005 and the first quarter of 2006 and began to decline to more normal levels beginning in the second quarter of 2006.

Our utilization rate is highly impacted by seasonal factors such as the vacation of our staff as well as client personnel. As a result, utilization rates are lower during the summer months of the third quarter than we experience during the first half of the year.

Number of Revenue-Generating Professionals. Revenue-generating professionals include both billable consultants that generate revenues based on hourly billing rates and other revenue generating employees who support our customers or develop software products.

	September 30, 2005		September 30, 2006		Percent
	Headcount	% of Total	Headcount	% of Total	Change
Forensic/Litigation	326	33.7%	389	33.5%	19.3%
Corporate Finance/Restructuring	333	34.5%	333	28.6%	
Economic Consulting	171	17.7%	202	17.4%	18.1%
Technology	136	14.1%	238	20.5%	75.0%
Total Company	966	100.0%	1,162	100.0%	20.3%

The number of revenue-generating professionals was affected by actions we took to reduce our workforce beginning in September 2006. These actions had the impact of reducing the number of revenue-generating professionals by 11 in our forensic/litigation practice, by 21 in our corporate finance/restructuring practice and by 19 in our economic consulting practice. The number of billable employees in the forensic/litigation practice increased primarily due to the acquisitions we completed during the third quarter of 2006. Excluding the impact of the workforce reduction, the number of billable professionals in the corporate finance/restructuring practice increased primarily due to the expansion

of our lender and transaction support group that assists lenders and other institutional clients in performing financial due diligence for loans, acquisitions and other transactions, such as stock option accounting issues. The number of billable professionals in the economic consulting practice increased primarily due to the acquisition of Compass in January 2006 that added 26 revenue-generating

professionals. The number of revenue-generating employees in our technology practices increased from September 30, 2005 to September 30, 2006 primarily due to increased demand for our services that began during the second half of 2005.

Average Billable Rate per Hour. We calculate average billable rate per hour by dividing (a) employee revenues for the period; excluding:

revenues generated from utilizing outside consultants;

revenues not associated with billable hours;

revenues resulting from reimbursable expenses; and

any large success fees not substantially attributable to billable hours generated by our professionals;
by (b) the number of hours worked on client assignments during the same period.

Average billable rates are presented below for each of our segments that primarily bill clients on an hourly basis. We have not presented average billable rates for our technology segment as more than half of its revenues are not generated on an hourly basis.

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2005	2006	Percent Change	2005	2006	Percent Change
Forensic/Litigation	$ 287	$ 332	15.7%	$ 289	$ 307	6.2%
Corporate Finance/Restructuring	388	417	7.5%	399	402	0.8%
Economic Consulting	368	393	6.3%	375	383	1.9%

Average hourly billable rates are affected by a number of factors, including:

the relative mix of our billable professionals (utilization and number of billable professionals at varying levels of billing rates);

our standard billing rates, which we have increased across all practices;

our clients perception of our ability to add value through the services we provide;

the market demand for our services;

introduction of new services by our competitors;

the pricing policies of our competitors;

- the mix of services that we provide;
- criteria related to the timing of achieving performance based success fee revenue;
- the level of revenue realization adjustments made during the period, including adjustments for potential or court ordered fee and expense adjustments; and
- general economic conditions.

Average billable rate per hour increased in our forensic/litigation practice primarily due to planned increases in billing rates during the third quarter of 2005 and the first and third quarters of 2006. Average billable rate per hour increased in our corporate finance/restructuring practice during the three and nine months ended September 30, 2006 as compared to 2005 primarily due to improved realization, higher success fees and a change in staff mix. Average billable rate per hour increased in our economic consulting practice during the three months ended September 30, 2006 as compared to 2005 primarily to due to planned billing rate increases implemented by Compass during the quarter. During the nine months ended September 30, 2006 as compared to 2005, the

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increase in average billable rate for the economic consulting practice was primarily due to planned billing rate increases implemented by our Lexecon group in January of 2006 and to a lesser extent due to the acquisition of Compass.

Segment Profits.

	2005		2006		
	Segment Profits	% of Segment Revenues	Segment Profits	% of Segment Revenues	Percent Change
			(dollars in thousands)		
Three Months Ended September 30					
Forensic/Litigation	$ 9,564	25.1%	$ 13,352	28.5%	39.6%
Corporate Finance/Restructuring	14,084	28.4%	12,026	23.7%	(14.6)%
Economic Consulting	7,211	25.4%	7,631	22.1%	5.8%
Technology	7,222	42.2%	11,346	37.9%	57.1%
Corporate	(7,803)		(9,644)		(23.6)%
Total Company	$ 30,278	22.7%	$ 34,711	21.4%	14.6%
Nine Months Ended September 30					
Forensic/Litigation	$ 33,862	29.5%	$ 39,702	27.9%	17.2%
Corporate Finance/Restructuring	41,281	30.5%	36,412	23.5%	(11.8)%
Economic Consulting	19,880	24.4%	25,877	23.9%	30.2%
Technology					