

Watson Wyatt Worldwide, Inc.  
Form 10-Q  
May 10, 2006

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 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: 001-16159

**WATSON WYATT WORLDWIDE, INC.**

(Exact name of registrant as specified in its charter)

Delaware

52-2211537

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(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

**901 N. Glebe Rd., Arlington, VA**  
(Address of principal executive offices)

**22203**  
(Zip Code)

**703-258-8000**

(Registrant's telephone number, including area code)

**n/a**

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  NO

Indicate by check mark whether the registrant is 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

Accelerated filer

Non-accelerated filer

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

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

Class	Outstanding at April 28, 2006
Class A Common Stock, \$.01 par value	42,312,725 shares

**WATSON WYATT WORLDWIDE, INC.**  
**INDEX TO FORM 10-Q**

For the Three and Nine Months Ended March 31, 2006

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**WATSON WYATT WORLDWIDE, INC.**  
**Consolidated Statements of Operations**  
(Thousands of U.S. Dollars, Except Per Share Data)

	Three months ended March 31		Nine months ended March 31	
	2006	2005	2006	2005
	(Unaudited)		(Unaudited)	
Revenue	\$ 343,072	\$ 187,560	\$ 924,722	\$ 538,800
Costs of providing services:				
Salaries and employee benefits	191,582	101,730	514,339	294,000
Professional and subcontracted services	17,884	13,795	56,490	37,318
Occupancy, communications and other	41,689	27,110	118,229	79,111
General and administrative expenses	39,300	18,764	107,895	55,133
Depreciation and amortization	11,510	5,161	32,319	14,654
	301,965	166,560	829,272	480,216
Income from operations	41,107	21,000	95,450	58,584
Income from affiliates	310	889	1,732	5,819
Interest income	1,047	761	2,344	1,914
Interest expense	(1,344)	(144)	(3,703)	(435)
Other non-operating (loss) income	44	(1,181)	(2,106)	(1,209)
Income from continuing operations before income taxes	41,164	21,325	93,717	64,673
Provision for income taxes	11,828	6,985	33,314	25,527
Income from continuing operations	29,336	14,340	60,403	39,146
Discontinued operations:				
Adjustment to reduce estimated loss on disposal of discontinued operations [less applicable income tax expense for the three and nine months ended March 31, 2006 and 2005]	1,035	739	1,035	739
Sublease income from discontinued operations, less applicable income tax expense for the three and nine months ended March 31, 2006 and 2005	10	9	27	17
Net income	\$ 30,381	\$ 15,088	\$ 61,465	\$ 39,902
Basic earnings per share:				
Income from continuing operations	\$ 0.69	\$ 0.44	\$ 1.47	\$ 1.20
Income from discontinued operations	0.02	0.02	0.03	0.02
Net income	\$ 0.71	\$ 0.46	\$ 1.50	\$ 1.22
Diluted earnings per share:				
Income from continuing operations	\$ 0.69	\$ 0.44	\$ 1.46	\$ 1.19
Income from discontinued operations	0.02	0.02	0.03	0.02
Net income	\$ 0.71	\$ 0.46	\$ 1.49	\$ 1.21
Weighted average shares of common stock, basic (000)	42,234	32,647	41,074	32,507
Weighted average shares of common stock, diluted (000)	42,466	32,936	41,341	32,814

See accompanying notes to the  
consolidated financial statements



**WATSON WYATT WORLDWIDE, INC.**  
**Consolidated Balance Sheets**  
(Thousands of U.S. Dollars, Except Share and Per Share Data)

	<b>March 31, 2006 (Unaudited)</b>	<b>June 30, 2005</b>
<b>Assets</b>		
Cash and cash equivalents	\$ 92,674	\$ 168,076
Receivables from clients:		
Billed, net of allowances of \$4,211 and \$2,114	173,831	95,977
Unbilled, net of allowances of \$7,241 and \$264	126,711	62,840
	300,542	158,817
Deferred income taxes	19,054	24,718
Other current assets	34,249	12,599
<b>Total current assets</b>	<b>446,519</b>	<b>364,210</b>
Investment in affiliates	10,045	30,857
Fixed assets, net	135,832	94,033
Deferred income taxes	114,885	92,915
Goodwill	306,146	21,888
Intangible assets	177,926	776
Other assets	6,752	14,000
<b>Total Assets</b>	<b>\$ 1,198,105</b>	<b>\$ 618,679</b>
<b>Liabilities</b>		
Accounts payable and accrued liabilities, including discretionary compensation	\$ 238,250	\$ 122,621
Deferred income taxes		283
Income taxes payable	21,869	4,648
<b>Total current liabilities</b>	<b>260,119</b>	<b>127,552</b>
Note payable	45,000	
Accrued retirement benefits	263,342	205,029
Deferred rent and accrued lease losses	29,292	18,701
Deferred income taxes	361	370
Other noncurrent liabilities	69,960	32,824
<b>Total Liabilities</b>	<b>668,074</b>	<b>384,476</b>
Commitments and contingencies		
<b>Stockholders Equity</b>		
Preferred Stock - No par value: 1,000,000 shares authorized; none issued and outstanding		
Class A Common Stock - \$.01 par value: 99,000,000 shares authorized; 42,463,451 and 33,372,880 issued and 42,271,095 and 32,627,226 outstanding	425	334
Additional paid-in capital	386,535	147,948
Treasury stock, at cost - 192,356 and 745,654 shares	(5,050)	(18,705)
Retained earnings	220,052	168,075
Accumulated other comprehensive loss	(71,931)	(63,449)
<b>Total Stockholders Equity</b>	<b>530,031</b>	<b>234,203</b>
<b>Total Liabilities and Stockholders Equity</b>	<b>\$ 1,198,105</b>	<b>\$ 618,679</b>

See accompanying notes to the  
consolidated financial statements



**WATSON WYATT WORLDWIDE, INC.**  
**Consolidated Statements of Cash Flows**  
(Thousands of U.S. Dollars)

	<b>Nine months ended March 31</b>	
	<b>2006</b>	<b>2005</b>
	<b>(Unaudited)</b>	
<b>Cash flows from (used in) operating activities:</b>		
Net income	\$ 61,465	\$ 39,902
<b>Adjustments to reconcile net income to net cash used in operating activities:</b>		
Loss on foreign currency forward contract	3,602	
Income from discontinued operations, net of income tax expense	(1,035 )	(739 )
Provision for doubtful receivables from clients	6,089	5,967
Depreciation	26,448	14,426
Amortization of intangible assets	5,872	228
Provision for deferred income taxes	9,876	7,029
Income from affiliates	(1,732 )	(5,819 )
Distributions from affiliates	1,614	4,624
Other, net	326	755
<b>Changes in operating assets and liabilities (net of discontinued operations)</b>		
Receivables from clients	(33,731 )	(22,124 )
Other current assets	(4,929 )	(9,996 )
Other assets	(684 )	1,091
Accounts payable and accrued liabilities	(31,278 )	(12,126 )
Income taxes payable	16,620	(20,824 )
Accrued retirement benefits	412	(261 )
Deferred rent and accrued lease losses	1,870	394
Other noncurrent liabilities	4,205	(481 )
Cash flows from operating activities:	65,010	2,046
<b>Cash flows (used in) from investing activities:</b>		
Purchases of marketable securities		(469,400 )
Sales and maturities of marketable securities		489,400
Acquisitions	(132,844 )	(517 )
Purchases of fixed assets	(24,153 )	(20,129 )
Capitalized software costs	(20,477 )	(8,840 )
Proceeds from divestitures	1,496	28
Cash flows used in investing activities:	(175,978 )	(9,458 )
<b>Cash flows from (used in) financing activities:</b>		
Borrowings	102,000	
Repayments of borrowings	(57,000 )	
Foreign currency forward contract	(8,405 )	
Dividends paid	(9,487 )	(7,309 )
Repurchases of common stock	(3,937 )	(4,188 )
Tax benefit of exercises of stock options and other	1,444	775
Issuances of common stock - exercises of stock options	2,921	1,711
Issuances of common stock - employee stock purchase plan	4,777	5,549
Cash flows from (used in) financing activities:	32,313	(3,462 )
Effect of exchange rates on cash	3,253	399
Decrease in cash and cash equivalents	(75,402 )	(10,475 )
Cash and cash equivalents at beginning of period	168,076	136,940
Cash and cash equivalents at end of period	\$ 92,674	\$ 126,465



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See accompanying notes to the  
consolidated financial statements

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**WATSON WYATT WORLDWIDE, INC.**  
**Consolidated Statement of Changes in Stockholders' Equity**  
(Thousands of U.S. Dollars)

	Class A Common Stock Outstanding (number of shares, in thousands)	Class A Common Stock	Additional Paid-in Capital	Treasury Stock, at Cost	Retained Earnings	Accumulated Other Comprehensive (Loss)/Income	Total
Balance at June 30, 2005	32,627	\$ 334	\$ 147,948	\$ (18,705)	\$ 168,075	\$ (63,449)	\$ 234,203
Comprehensive income:							
Net income					61,465		61,465
Additional minimum pension liability						160	160
Foreign currency translation adjustment						(8,642)	(8,642)
Total comprehensive income							52,983
Cash dividends declared					(9,488)		(9,488)
Repurchases of common stock	(141)			(3,937)			(3,937)
Issuances of common stock - employee stock purchase plan shares	184		151	4,626			4,777
Issuances of common stock - deferred stock units and other	181		718	4,555			5,273
Issuances of common stock to outside directors	11		15	333			348
Issuances of common stock - stock options	225		(2,829)	5,750			2,921
Acquisition of WWLLP	9,091	91	238,627				238,718
Other business acquisition	93		172	2,328			2,500
Non-qualified stock option expense			289				289
Tax benefit of exercises of stock options			1,444				1,444
Balance at March 31, 2006 (unaudited)	42,271	\$ 425	\$ 386,535	\$ (5,050)	\$ 220,052	\$ (71,931)	\$ 530,031

See accompanying notes to the consolidated financial statements

**WATSON WYATT WORLDWIDE, INC.**

**Notes to the Consolidated Financial Statements**

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

**Note 1 Basis of Presentation.**

The accompanying unaudited quarterly consolidated financial statements of Watson Wyatt Worldwide, Inc. and our subsidiaries (collectively referred to as we, Watson Wyatt, Watson Wyatt Worldwide or the company) are presented in accordance with the rules and regulations of the Securities and Exchange Commission (SEC) for quarterly reports on Form 10-Q. In the opinion of management, these consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, which are necessary for a fair presentation of the consolidated financial statements and results for the interim periods. The consolidated financial statements should be read together with the audited consolidated financial statements and notes thereto contained in the company's Annual Report on Form 10-K for the fiscal year ended June 30, 2005, which is filed with the SEC and may be accessed via EDGAR on the SEC's web site at [www.sec.gov](http://www.sec.gov). The year-end balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. generally accepted accounting principles.

The results of operations for the nine months ended March 31, 2006 are not necessarily indicative of the results that can be expected for the entire fiscal year ending June 30, 2006. The results reflect certain estimates and assumptions made by management including estimated bonuses and anticipated tax liabilities that affect the amounts reported in the consolidated financial statements and related notes. Certain prior year amounts have been reclassified to conform to the current year's presentation.

**Note 2 Business Combination.**

On July 31, 2005, the company acquired substantially all of the assets and assumed most liabilities of Watson Wyatt LLP (WWLLP) (the business combination), a leading United Kingdom-based actuarial, benefits and human resources consulting partnership. The company and WWLLP had jointly offered services since 1995 pursuant to alliance agreements and as a result, have business segments that are very similar in nature. See Note 3 for further information regarding the operating segments of the combined company.

The assets acquired from WWLLP are held by the company's principal U.K. subsidiary, Watson Wyatt Limited, thereby strengthening Watson Wyatt's global market presence. The purchase price of \$432.6 million consisted of £88.3 million in cash, or \$156.1 million at the exchange rate in effect at August 1, 2005, the issuance of 9,090,571 shares of the company's common stock valued at \$238.7 million, transaction costs of \$14.6 million and additional consideration including debt forgiveness and investment elimination. The shares paid were valued at \$26.26 per share, which was the average of the closing market prices of the company's stock over five business days beginning with two business days prior to the announcement date of January 18, 2005 and ending with the two business days following the announcement date. In addition, a further 1,950,000 shares may be paid to WWLLP as additional consideration after June 30, 2007, contingent upon the achievement by the acquired business of certain agreed-upon financial performance goals. Watson Wyatt Limited's results of operations are included in the consolidated financial statements beginning August 1, 2005.

*Accounting and Goodwill Allocation*

The business combination has been accounted for using the purchase method of accounting as prescribed in Statement of Financial Accounting Standards No. 141, Business Combinations (SFAS 141), where the assets acquired and liabilities assumed are recorded at their respective fair values as of the combination date. As of the business combination date, the company determined the following estimated fair values for the proportionate assets purchased and liabilities assumed. The determination of estimated fair value requires management to make significant estimates and assumptions. The company hired an independent third party to assist in the valuation of assets. Although the company does not anticipate any significant adjustments, to the extent that the estimates used need to be refined, the company will do so upon making that determination but not later than one year from the business combination date.

	<b>August 1, 2005</b>	
	<b>(in thousands)</b>	
Total purchase price		\$ 432,618
Less net assets acquired:		
Trademark and trade name	\$ 108,000	
Customer related intangibles	60,600	
Core/developed technology	17,500	
Cash and cash equivalents	26,419	
Client receivables and unbilled revenue	94,324	
Other current assets	40,892	
Fixed assets	11,270	
Other assets	3,368	
Current liabilities	(139,381 )	
Accrued retirement benefits	(43,064 )	
Other non current liabilities	(29,240 )	
		150,688
Preliminary allocation of goodwill		\$ 281,930

The preliminary allocation of the purchase price resulted in the allocation of \$281.9 million to goodwill, which has been assigned to our segments as follows:

	<b>Goodwill</b>
Benefits	\$ 136,454
Technology and Administration Solutions Group	40,034
Human Capital Group	16,070
Insurance & Financial Services Group	52,157
Investment Consulting Group	37,215
Allocation of goodwill to business segments	\$ 281,930

The majority of the goodwill will be deductible in the U.K. over a period not exceeding 25 years.

*Hedge Treatment*

During the third quarter of fiscal year 2005, the company entered into a foreign currency forward contract to offset the risk associated with the foreign exchange (British Pound) exposure inherent in the combination. The forward contract provided for the purchase of £88 million at a fixed price of \$164.5 million, with a settlement date of July 29, 2005. In accordance with Statement of Financial Accounting Standards No. 133,

Accounting for Derivative Instruments and Hedging Activities (SFAS 133), as amended and interpreted, since the forward contract was associated with a business combination that is subject to the provisions of SFAS 141 and the combination involved an equity method investment, the forward contract did not qualify for hedge accounting. As a result, changes in fair value associated with the forward contract were required to be recognized in the Consolidated Statements of Operations. Consequently, a loss of \$3.6 million was recognized during the first quarter of fiscal year 2006 and included in other non-operating income. Losses recognized under this forward contract since inception of the contract totaled \$8.4 million.

*Pro Forma Financial Information*

The following unaudited pro forma combined statements of operations have been provided to present illustrative combined unaudited statements of operations for the three and nine month periods ended March 31, 2006 and 2005, giving effect to the business combination as if it had been completed on July 1, 2005 and 2004, respectively. The unaudited historical combined statement of operations for the three month period ended March 31, 2006 reflects the actual financial results of the combined company. The three month period ended March 31, 2005 combines the historical financial results of Watson Wyatt for the three months ended March 31, 2005 with the pro forma historical financial results from WWLLP for the three months ended March 31, 2005. The nine month period ended March 31, 2006 includes historical financial results from July 2005 of Watson Wyatt, pro forma results of WWLLP for the month of July 2005, combined with the results of the consolidated entity from August 1, 2005 through March 31, 2006. The nine month period ended March 31, 2005 combines the historical financial results of Watson Wyatt for the nine months ended March 31, 2005 with the pro forma historical financial results from WWLLP for the nine months ended March 31, 2005.

The unaudited pro forma combined financial information shows the impact of the business combination on Watson Wyatt's historical results of operations. The unaudited pro forma combined income statements are presented for illustrative purposes only and are not indicative of the results of operations that might have occurred had the business combination actually taken place as of the dates specified, or that may be expected to occur in the future. They do not assume any benefits from any cost savings or synergies and do not reflect any integration costs that the combined company realized or incurred after the combination.

**Pro-Forma Combined Statements of Operations**

(in thousands, except per share data)

	Three Months Ended March 31,			Nine Months Ended March 31,		
	2006 (Unaudited)	2005	% Change	2006 (Unaudited)	2005	% Change
Revenue	\$ 343,072	\$ 306,661	11.9 %	\$ 961,641	\$ 891,233	7.9 %
Costs of providing services:						
Salaries and employee benefits	191,582	176,762	8.4	538,379	505,098	6.6
Professional and subcontracted services	17,884	17,804	0.4	57,681	50,340	14.6
Occupancy, communications and other	41,689	39,618	5.2	121,420	114,442	6.1
General and administrative expenses	39,300	35,934	9.4	114,493	109,808	4.3
Depreciation and amortization	11,510	10,081	14.2	33,744	28,646	17.8
	301,965	280,199	7.8	865,717	808,334	7.1
Income from operations	41,107	26,462	55.3	95,924	82,899	15.7
Income (loss) from affiliates	310	(1,306 )	123.7	1,244	(261 )	576.6
Interest expense, net	(297 )	(865 )	(65.7 )	(1,772 )	(2,519 )	(29.7 )
Other non-operating income (loss)	44	(1,198 )	103.7	1,496	(1,226 )	222.0
Income from continuing operations before income taxes	41,164	23,093	78.3	96,892	78,893	22.8
Provision for income taxes	11,828	8,263	43.1	34,610	27,989	23.7
Income from continuing operations	\$ 29,336	\$ 14,830	97.8 %	\$ 62,282	\$ 50,904	22.4 %
Basic earnings per share:	\$ 0.69	\$ 0.36		\$ 1.52	\$ 1.22	
Diluted earnings per share:	\$ 0.69	\$ 0.35		\$ 1.51	\$ 1.21	
Weighted average shares of common stock, basic (000)	42,234	41,737		41,074	41,597	
Weighted average shares of common stock, diluted (000)	42,466	42,026		41,341	41,904	

**Note 3 Segment Information.**

In North America and Europe, the company is primarily organized and managed by practice. Although our consultants in our Asia-Pacific and Latin America offices provide services in these same practice areas, their operations as a whole are managed geographically and comprise a single operating segment. As a result, we have six reportable operating segments or practice areas as follows:

- (1) Benefits Group
- (2) Technology and Administration Solutions Group
- (3) Human Capital Group
- (4) Insurance & Financial Services Group
- (5) Investment Consulting Group
- (6) International Comprising Asia Pacific and Latin America

Management evaluates the performance of its segments and allocates resources to them based on net operating income on a pre-bonus, pre-tax basis. The category previously reported as other has been reclassified as All other segments in the reconciliation of reportable segments to consolidated amounts as prescribed in Statement of Financial Accounting Standards No. 131 Disclosures about Segments of an Enterprise and Related Information, (SFAS 131). This includes communication and change management implementation support services. Prior period amounts have been restated to conform to the current classification.

The table below presents specified information about reported segments as of and for the three months ended March 31, 2006. As a result, it includes the consolidated results from the acquired businesses, as now held by Watson Wyatt Limited:

	<b>Benefits Group</b>	<b>Technology and Administration Solutions Group</b>	<b>Human Capital Group</b>	<b>Insurance &amp; Financial Services Group</b>	<b>Investment Consulting Group</b>	<b>International Asia-Pacific/Latin America</b>	<b>Total</b>
Revenue (net of reimbursable expenses)	\$ 188,573	\$ 35,449	\$ 27,568	\$ 27,847	\$ 20,735	\$ 23,828	\$ 324,000
Net operating income	55,051	8,708	3,469	8,075	4,581	2,122	82,006
Receivables	184,954	13,576	25,877	28,724	13,479	21,648	288,258

The table below presents specified information about reported segments as of and for the three months ended March 31, 2005. As a result, it does not include results from Watson Wyatt Limited since the combination was not completed until July 31, 2005:

	<b>Benefits Group</b>	<b>Technology and Administration Solutions Group</b>	<b>Human Capital Group</b>	<b>Insurance &amp; Financial Services Group</b>	<b>Investment Consulting Group</b>	<b>International Asia-Pacific/Latin America</b>	<b>Total</b>
Revenue (net of reimbursable expenses)	\$ 109,482	\$ 17,030	\$ 14,633	\$	\$ 5,005	\$ 22,190	\$ 168,340
Net operating income	24,693	874	3,622		136	263	29,588
Receivables	108,372	7,263	13,487		4,301	20,844	154,267





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The table below presents specified information about reported segments as of and for the nine months ended March 31, 2006. As a result, it includes the consolidated results from Watson Wyatt Limited since August 1, 2005. Net operating income presented below has been adjusted to correct amounts that were inadvertently misstated primarily in the Technology and Administration Solutions Group for the quarter ended September 30, 2005, improving margins in the Technology and Administration Solutions Group from what was previously reported.

	<b>Benefits Group</b>	<b>Technology and Administration Solutions Group</b>	<b>Human Capital Group</b>	<b>Insurance &amp; Financial Services Group</b>	<b>Investment Consulting Group</b>	<b>International Asia-Pacific/Latin America</b>	<b>Total</b>
Revenue (net of reimbursable expenses)	\$ 504,966	\$ 96,296	\$ 80,414	\$ 65,449	\$ 52,626	\$ 68,251	\$ 868,002
Net operating income	130,157	24,339	12,217	13,599	8,319	2,797	191,428
Receivables	184,954	13,576	25,877	28,724	13,479	21,648	288,258

The table below presents specified information about reported segments as of and for the nine months ended March 31, 2005. As a result, it does not include results from Watson Wyatt Limited since the combination was not completed until July 31, 2005:

	<b>Benefits Group</b>	<b>Technology and Administration Solutions Group</b>	<b>Human Capital Group</b>	<b>Insurance &amp; Financial Services Group</b>	<b>Investment Consulting Group</b>	<b>International Asia-Pacific/Latin America</b>	<b>Total</b>
Revenue (net of reimbursable expenses)	\$ 305,503	\$ 53,785	\$ 41,998	\$	\$ 13,705	\$ 65,487	\$ 480,478
Net operating income	63,280	8,975	10,589		626	2,074	85,544
Receivables	108,372	7,263	13,487		4,301	20,844	154,267

Information about interest income and tax expense is not presented as a segment expense because such items are not considered a responsibility of the segments' operating management. Prior year data has been reclassified to be consistent with current segments for comparative purposes.

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Reconciliations of the information reported by segment to the historical consolidated amounts follow for the three and nine month periods ended March 31, 2006 and 2005:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2006	2005	2006	2005
<b>Revenue:</b>				
Total segment revenue	\$ 324,000	\$ 168,340	\$ 868,002	\$ 480,478
Reimbursable expenses not included in total segment revenue	8,376	9,340	28,331	25,619
All other segments	8,058	9,082	26,324	31,811
Other, net	2,638	798	2,065	892
Consolidated revenue	\$ 343,072	\$ 187,560	\$ 924,722	\$ 538,800
<b>Net Operating Income:</b>				
Total segment net operating income	\$ 82,006	\$ 29,588	\$ 191,428	\$ 85,544
Income from affiliates	310	889	1,732	5,819
Differences in allocation methods for depreciation, G&A, medical and pension costs (1)	500	5,325	(5,887)	1,313
Gain on sale of business units	44	48	1,496	20
Interest expense	(1,344)	(144)	(3,703)	(435)
Gain (Loss) on hedge		1,392	(3,602)	1,392
Discretionary compensation	(33,073)	(11,400)	(80,305)	(31,813)
WBG loss accrual		(2,203)		(2,203)
All other segments	(1,056)	(488)	(2,272)	3,025
Other, net	(6,223)	(1,682)	(5,170)	2,001
Consolidated income before income taxes	\$ 41,164	\$ 21,325	\$ 93,717	\$ 64,673
<b>Receivables:</b>				
Total segment receivables billed and unbilled	\$ 288,258	\$ 154,267	\$ 288,258	\$ 154,267
All other segments	5,574	6,670	5,574	6,670
Net valuation differences (2)	6,710	5,054	6,710	5,054
Total billed and unbilled receivables	300,542	165,991	300,542	165,991
Assets not reported by segment (3)	897,563	369,133	897,563	369,133
Consolidated assets	\$ 1,198,105	\$ 535,124	\$ 1,198,105	\$ 535,124

(1) Depreciation, general and administrative, pension, and medical costs are allocated to our segments based on budgeted expenses determined at the beginning of the fiscal year as management believes that these costs are largely uncontrollable to the segment. To the extent that the actual expense base upon which allocations are made differs from the forecast/budget amount, a reconciling item will be created between internally allocated expenses and the actual expense that we report for GAAP purposes.

(2) Total segment receivables, which reflects the receivable balances used by management to make business decisions, are included for management reporting purposes net of deferred revenues less cash collections and invoices generated in excess of revenue recognized in the segment revenues and cash held in suspense.

(3) Assets not reported by segment for management reporting purposes include goodwill and intangible assets of \$484.1 million.

**Note 4 Share-based Compensation.**

The Financial Accounting Standards Board (FASB) issued SFAS123(R), *Share-based Payment* as a revision to Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation*. SFAS 123(R) requires companies to account for share-based payment transactions with employees using a fair-value based method, thereby eliminating the disclosure-only provisions of SFAS 123. SFAS 123(R) became effective for the company as of July 1, 2005.

The company has four share-based compensation plans, which are described below. These compensation plans include the 2001 Employee Stock Purchase Plan, the 2001 Deferred Stock Unit Plan for Selected Employees, the Amended Compensation Plan for Outside Directors and the 2000 Long-Term Incentive Plan. All four plans have been approved by stockholders.

*2001 Employee Stock Purchase Plan*

The employee stock purchase plan enables employees to purchase shares of the company's stock. No compensation expense was recognized through the third quarter of fiscal year 2006 as a result of this plan. Pro forma compensation expense of \$1.0 million was disclosed for the nine months ended March 31, 2005.

*2001 Deferred Stock Unit Plan for Selected Employees*

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The 2001 Deferred Stock Unit Plan for Selected Employees is intended to provide selected associates of the company with additional incentives by permitting the company to grant them an equity interest in the company in the form of restricted stock units, in lieu of a portion of their annual fiscal year end bonus. Shares under this plan are awarded during the first quarter of each fiscal year. During the first quarter of fiscal year 2006, 177,300 shares of common stock, at a market price of \$26.94 were awarded for a total fair value of \$4.8 million. During the first quarter of fiscal year 2005, 151,610 shares of common stock, at a market price of \$26.68 were awarded, for a total fair value of \$4.0 million. In addition, under the 2001 Deferred Stock Unit Plan for Selected Employees, the company also awarded approximately 4,000 shares, at a market price per share of \$30.05 for a total fair value of approximately \$0.2 million, during the third quarter of fiscal year 2006 in connection with the Chairman's Award Program. The Chairman's Award Program recognizes certain employees who have made outstanding contributions to strategy execution.

On November 19, 2004, the company's Board of Directors approved a long-term bonus arrangement pursuant to the company's 2001 Deferred Stock Unit Plan for Selected Employees. The arrangement, called the Performance Share Bonus Incentive Program (the SBI Program), is a long-term stock bonus arrangement for senior executives of the company and its affiliates that is designed to strengthen incentives and align behaviors to grow the business in a way that is consistent with the strategic goals of the company.

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Incentives under the SBI Program are provided through grants of deferred stock units pursuant to the company's 2001 Deferred Stock Unit Plan for Selected Employees. Grants of deferred stock units are based on the value of the cash portion of the eligible participant's fiscal year-end bonus target and a multiplier, which is then converted into a target number of deferred stock units based upon the company's stock price as of the fiscal year-end prior to grant. Participants may vest between zero and 170% of the target number of deferred stock units based on the extent to which financial and strategic performance metrics are achieved over a three fiscal year period. The financial and strategic performance metrics are established at the beginning of each performance period. For the fiscal 2004 through 2007 performance period, the vesting criteria are based upon earnings per share growth, market penetration and cross-selling ratios.

No compensation expense was recorded pursuant to this plan through the first nine months of fiscal year 2006. Expenses for this plan will be recognized when awards are both probable and reasonably estimable and compensation expense will be recognized as a component of the discretionary annual bonus recorded in salaries and employee benefits.

*Amended Compensation Plan for Outside Directors*

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The Amended Compensation Plan for Outside Directors (the Outside Director's Plan) provides for cash and stock compensation of outside Directors. Under the Outside Director's Plan, outside Directors are initially paid in shares of the company's common stock, or in a combination of cash and shares, quarterly for services provided during the preceding quarter. Approximately \$0.3 million of compensation expense was recorded relative to this plan during the first nine months of fiscal year 2006 compared to \$0.2 million in the first nine months of fiscal year 2005.

### *2000 Long-Term Incentive Plan*

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The company issued non-qualified stock options under the 2000 Long-Term Incentive Plan (the Stock Option Plan ) in conjunction with its initial public offering in fiscal year 2001. No options have been granted under the stock option plan since fiscal year 2001 and the company does not currently intend to issue further stock options under the Stock Option Plan. For the first nine months of fiscal year 2006, the company recognized \$0.3 million in compensation expense related to the Stock Option Plan, in accordance with SFAS 123(R). For the first nine months of fiscal year 2005, the company disclosed pro forma compensation cost of \$0.7 million, related to the Stock Option Plan.

### **Note 5 Retirement Benefits.**

#### *Defined Benefit Plans*

We sponsor both qualified and non-qualified, non-contributory defined benefit pension plans covering substantially all of our associates. Under our plans in North America and Hong Kong, benefits are based on the number of years of service and the associates' compensation during the five highest paid consecutive years of service (subject to grandfathering provisions under which benefits would be determined based on the three highest paid consecutive years of service). The non-qualified plan, which exists only in North America, provides for pension benefits that would be covered under the qualified plan but are limited by the Internal Revenue Code. The non-qualified plan has no assets and therefore is an unfunded arrangement. The benefit liability is reflected on the balance sheet. The measurement date for the plans is June 30.

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As a result of the business combination described in Note 2, we have included the defined benefit pension plan disclosures for our recently acquired U.K. operations. The disclosures for this plan, together with our historical U.K. plan (collectively the U.K. Plans ), are shown separately from the North America and Hong Kong plans because the related amounts, including obligations, assets and net periodic benefit costs, are significant, and the assumptions used are significantly different, than all other plans sponsored by the company. Benefits under the U.K. plans are based on the number of years of service and the associates' compensation during the three years before leaving the plan. The measurement date for the defined benefit plan for the recently combined U.K. operations is July 31 whereas the measurement date for the historical U.K. plan is June 30.

*Components of Net Periodic Benefit Cost for Defined Benefit Pension Plans*

The following table sets forth the components of net periodic benefit cost for the company's defined benefit pension plan for North America and Hong Kong for the three and nine month periods ended March 31, 2006 and 2005, and for the U.K. plans for the three and nine months ended March 31, 2006:

	Three Months Ended March 31, 2006			2005			Nine Months Ended March 31, 2006			2005
	North America & Hong Kong	U.K.	Total	North America & Hong Kong	North America & Hong Kong	U.K.(1)	Total	North America & Hong Kong	North America & Hong Kong	
Service Cost	\$ 7,635	\$ 3,050	\$ 10,685	\$ 6,321	\$ 22,854	\$ 8,275	\$ 31,129	\$ 18,933		
Interest Cost	9,362	3,798	13,160	8,852	28,032	10,414	38,446	26,515		
Expected Return on Plan Assets	(11,170 )	(3,604 )	(14,774 )	(10,363 )	(33,447 )	(9,891 )	(43,338 )	(31,042 )		
Amortization of Transition Obligation	(2 )		(2 )	(2 )	(6 )		(6 )	(5 )		
Amortization of Net Loss	4,041		4,041	1,702	12,104		12,104	5,100		
Amortization of Prior Service Cost	(429 )		(429 )	(540 )	(1,290 )		(1,290 )	(1,621 )		
Net Periodic Benefit Cost	\$ 9,437	\$ 3,244	\$ 12,681	\$ 5,970	\$ 28,247	\$ 8,798	\$ 37,045	\$ 17,880		

(1) Reflects the net periodic benefit cost for (1) the defined benefit pension plan for our recently combined U.K. operations for the eight month period ending March 31, 2006 and (2) the historical U.K. plan for the nine months ended March 31, 2006.



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The fiscal year 2006 net periodic benefit cost is based, in part, on the following rate assumptions as of June 30, 2005 for the North America and Hong Kong plans and July 31, 2005 for the U.K. plans:

	North America & Hong Kong	U.K.
Discount rate	5.25%	5.00%
Expected long-term rate of return on assets	9.00%	5.63%
Rate of increase in compensation levels	3.34%	4.75%

The discount rate applicable to the various plans varies in accordance with the interest rate environment in the respective host country. The expected long-term rate of return on assets attributable to the various plans is based on the allocation of assets within each specific plan. Assets in the North America and Hong Kong plans are heavily weighted in equities, which are expected to generate a higher return than bonds, which constitute the majority of investments for the UK plans.

### *Employer contributions*

The company made \$0.8 million in contributions to the non-U.S. plans during the third quarter of fiscal year 2006 and no contributions to the U.S. plans in the third quarter. We anticipate making \$0.8 million in contributions to the non-U.S. plans in the last quarter of fiscal year 2006. We do not anticipate making additional contributions to the U.S. plan for the remainder of fiscal year 2006.

The company made \$2.2 million in contributions to the U.K. plans during the third quarter of fiscal year 2006 and anticipates making \$4.8 million in contributions over the remainder of fiscal year 2006.

### *Defined Contribution Plans*

In the U.S., we sponsor a savings plan that provides benefits to substantially all U.S. associates with a match to employee contributions at a rate of 50 percent of the first 6 percent up to \$60,000 of associates' eligible compensation. The company may also make an annual profit sharing contribution to the plan in an amount that is dependant upon the company's financial performance during the fiscal year.

In the U.K., we sponsor a savings plan that provides benefits to substantially all U.K. associates. The company provides a basic contribution and a match to employee contributions, both of which depend on age. The maximum employer contribution is 10% up to £91,000 of associates' eligible compensation.

### *Health Care Benefits*

In the U.S., we sponsor a contributory health care plan that provides hospitalization, medical and dental benefits to substantially all U.S. associates. We accrue a liability for estimated incurred but unreported claims based on projected use of the plan as well as prior plan history.

In the U.K., we sponsor a non-contributory medical insurance plan that provides hospitalization and medical benefits and a contributory dental plan that provides dental benefits to substantially all U.K. associates.

*Postretirement Benefits*

We provide certain health care and life insurance benefits for retired associates. The principal plans cover associates in the U.S. and Canada who have met certain eligibility requirements. Our principal post-retirement benefit plans are unfunded. We accrue a liability for these benefits in accordance with Statement of Financial Accounting Standards No. 106, Employers Accounting for Postretirement Benefits Other Than Pensions. We do not have postretirement benefit plans in the U.K. and Hong Kong.

*Components of Net Periodic Benefit Cost for Other Postretirement Plans*

The following table sets forth the components of net periodic benefit cost for the company's healthcare and post-retirement plans for the three and nine months ended March 31, 2006 and 2005:

	<b>Three Months Ended March 31,</b>		<b>Nine Months Ended March 31,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Service Cost	\$ 363	\$ 422	\$ 1,271	\$ 1,257
Interest Cost	538	612	1,746	1,831
Expected return on plan assets				
Amortization of transition obligation		13		38
Amortization of net loss	166	(142)	2	(425)
Amortization of prior service cost	(165)	(107)	(495)	(318)
Net periodic benefit cost	\$ 902	\$ 798	\$ 2,524	\$ 2,383

*Employer contributions*

The company made contributions in the form of premiums and medical claim payments to its healthcare and post-retirement plans of \$0.9 million in the three months ended March 31, 2006 and 2005, and contributions of \$2.5 million and \$2.1 million in the nine months ended March 31, 2006 and 2005, respectively. We plan to make additional payments estimated to total \$0.8 million through June 30, 2006.

**Note 6 Goodwill & Intangible Assets.**

The increases in goodwill and intangible assets outlined below for the nine months ended March 31, 2006 are principally attributable to the business combination during the first quarter. See Note 2 for further details regarding the business combination. The company performs its impairment tests in the fourth quarter of the company's fiscal year, based on closing balances in the third quarter.

	<b>Benefits Group</b>	<b>Technology and Administration Solutions Group</b>	<b>Human Capital Group</b>	<b>Insurance &amp; Financial Services Group</b>	<b>Investment Consulting Group</b>	<b>Asia-Pacific/ Latin America</b>	<b>All Other Segments</b>	<b>Total</b>
Balance as of June 30, 2005	\$ 16,790	\$ 1,449	\$ 77	\$	\$	\$ 2,358	\$ 1,214	\$ 21,888
Goodwill acquired during the year	143,458	40,034	16,070	52,157	37,215	666		289,600