
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K/A

(Mark One)

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

For the fiscal year ended December 31, 1999

OR

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

Commission File No. 0-28830

Navigant Consulting, Inc.

(Exact name of Registrant as specified in its charter)

Delaware
(State or other jurisdiction
of incorporation or organization)

36-4094854
(IRS Employer
Identification No.)

615 North Wabash Avenue, Chicago, Illinois 60611
(Address of principal executive offices, including zip code)

(312) 573-5600
(Registrant's telephone number, including area code)

Securities Registered Pursuant to Section 12(b) of the Act:

<u>Title of Each Class</u>	<u>Name of Each Exchange on Which Registered</u>
Common Stock, par value \$0.001 per share	New York Stock Exchange
Preferred Stock Purchase Rights	

Securities Registered Pursuant to Section 12(g) of the Act:

None

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

As of March 6, 2000, 41.1 million shares of the Registrants common stock, par value \$.001 per share ("Common Stock"), were outstanding. The aggregate market value of shares of Common Stock held by non-affiliates, based upon the closing sale price of the stock on the New York Stock Exchange on March 6, 2000, was approximately \$401.0 million.

The Registrant's Annual Meeting of Stockholders is scheduled to be held in the latter part of 2000.

Statements included in this report which are not historical in nature, are intended to be, and are hereby identified as, "forward-looking statements" for purposes of the Private Securities Litigation Reform Act of 1995. Such statements appear in a number of places in this report, including, without limitation, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations." When used in this report, the words "anticipate," "believe," "intend," "estimate," and "expect" and similar expressions as they relate to the Company or its management are intended to identify such forward-looking statements. The Company cautions readers that forward-looking statements, including without limitation, those relating to the Company's future business prospects, revenues, working capital, liquidity, and income, are subject to certain risks and uncertainties that could cause actual results to differ materially from those indicated in the forward looking statements, due to several important factors herein identified, among others, and other risks and factors identified from time to time in the Company's reports filed with the SEC. The Company undertakes no obligation to publicly update or revise any forward-looking statements to reflect current or future events or circumstances.

EXPLANATORY NOTE

This document incorporates our Annual Report on Form 10-K for the period ended December 31, 1999, as filed with the Securities and Exchange Commission (the "SEC") on March 28, 2000 (the "Original Filing") and the amendments to Form 10-K filed with the SEC on April 29, 2000, May 4, 2000 and on June 16, 2000.

This report continues to speak as of the date of the Original Filing and we have not updated the disclosure in this report to speak to any later date. While this report primarily relates to the historical period covered, events may have taken place since the date of the Original Filing that might have been reflected in this report if they had taken place prior to the Original Filing. Any items in the Original Filing not expressly changed hereby shall be as set forth in the Original Filing. All information contained in this amendment and the Original Filing is subject to updating and supplementing as provided in the Company's periodic reports filed with the SEC.

PART I

Item 1. Business

General

Navigant Consulting, Inc., formerly The Metzler Group, Inc., (“We” or the “Company”) is a provider of consulting services to electric and gas utilities, insurance companies and pharmaceutical companies, as well as other Fortune 100 companies. As of December 31, 1999, our services included: management consulting, strategic consulting, financial and claims services, and economics and policy consulting. We believe that our experience, reputation, industry focus and broad range of services will enable us to compete effectively in the consulting marketplace. Our growth strategy is to:

- Continue to build a complementary spectrum of consulting services;
- Leverage existing relationships and expand our client base in both domestic and international markets;
- Continue to recruit and retain highly skilled professionals; and
- Continue to acquire consulting companies that provide complementary services or geographic presence.

Our executive office is located at 615 North Wabash Avenue, Chicago, Illinois 60611. Our telephone number is (312) 573-5600.

Marketing and Sales

We market our services directly to mid-level and senior executives using a variety of business development and marketing techniques to communicate directly with current and prospective clients, including on-site presentations, industry seminars and industry-specific articles and other publications.

A significant portion of new business arises from prior client engagements. In addition, we seek to leverage the client relationships of firms we have acquired by cross-selling existing services. Clients frequently expand the scope of engagements during delivery to include follow-on complementary activities. Also, our on-site presence affords us the opportunity to become aware of, and to help define, additional project opportunities as they are identified by the client. The client relationships arising out of many engagements often facilitate our ability to market additional capabilities to clients in the future.

Human Resources

As of December 31, 1999, we had approximately 2,200 employees. Our success depends in large part on attracting, retaining and motivating talented, creative and experienced professionals at all levels. In connection with our hiring efforts, we employ internal recruiters, retain executive search firms and utilize personal and business contacts to recruit professionals with significant industry or consulting experience. Our consultants are drawn from the industries we serve and from accounting and other consulting organizations. We seek to promote loyalty and continuity of our consultants by offering packages of base and incentive compensation and benefits that we believe are attractive and competitive.

We derive our revenues almost exclusively from services performed by our professional consultants. Our future performance will continue to depend in large part upon our ability to attract and retain highly skilled professionals possessing appropriate skills and senior academics with superior professional reputations. Qualified professional consultants are in great demand and are likely to remain a limited resource for the foreseeable future. We may not be able to retain a substantial majority of our existing or future consultants for the long term. In addition, many of our consultants are not subject to non-competition or similar restrictions or are subject to such restrictions for only a limited period of time. The loss of the services of, or the failure to recruit, a significant number of consultants would adversely affect our ability to secure and complete engagements and would have a material adverse effect on our business.

In addition to the employees discussed above, we supplement our consultants on certain engagements with independent contractors, some of whom are former employees. We believe that the practice of retaining independent contractors on a per-engagement basis provides us with greater flexibility in adjusting professional personnel levels in response to changes in demand for our services.

Competition

We compete in the worldwide market for consulting services, although our principal market is North America, which accounted for over 95% of our revenues in 1999 and 1998. The market for consulting services is intensely competitive, highly fragmented and subject to rapid change. The market includes a large number of participants from a variety of market segments, including general management, information technology, and marketing consulting firms, as well as the consulting practices of national accounting firms, and other local, regional, national and international firms. Many of these companies are national and international in scope and have greater personnel, financial, technical and marketing resources than we do. We believe that our experience, reputation, industry focus and broad range of services will enable us to compete effectively in the consulting marketplace.

Item 2. Properties

Our headquarters are currently located in a 15,000 square foot building in Chicago, Illinois which we own. In addition to our headquarters, we have approximately 100 operating leases for office facilities worldwide. Additional space may be required as our business expands geographically, but we believe we will be able to obtain suitable space as needed. We have principal offices in the following cities:

Austin, TX	Emeryville, CA	New York City, NY
Baltimore, MD	Ft. Lauderdale, FL	Princeton, NJ
Boston, MA	Houston, TX	Sacramento, CA
Burlington, MA	London, England	San Francisco, CA
Chicago, IL	Los Angeles, CA	Washington, DC
Cleveland, OH	Menlo Park, CA	Westminster, CO
Dallas, TX		

Item 3. Legal Proceedings

Numerous purported class action lawsuits have been filed against the Company since November 1999 in the United States District Court for the Northern District of Illinois. These actions name as defendants the Company and certain former directors and former executive officers (one of whom, however, remains an employee of the Company) of the Company and are purported to be on behalf of persons who purchased shares of the Company's common stock during various periods through November 1999. The complaints allege various violations of federal securities law, including violations of Section 10(b) of the Securities Exchange Act of 1934, and that the defendants made materially misleading statements and/or material omissions which artificially inflated prices for the Company's common stock. The plaintiffs seek a judgement awarding damages and other relief. The Company believes it has meritorious defenses and intends to vigorously defend these actions. The outcome of these lawsuits cannot be predicted with certainty and a material adverse judgement against the Company could have a material adverse effect on the Company.

Navigant International, Inc., a national travel agency headquartered in Denver, Colorado, sued the Company in July 1999 in the United States District Court for the District of Colorado claiming that the use of "Navigant" in our name infringes on their use of and rights in such name. The complaint seeks declaratory relief and an injunction against our use of "Navigant," attorneys' fees and other related relief. The Company believes it has meritorious defenses and intends to vigorously defend this action.

During the fourth quarter of 1999 the Company settled a previously disclosed lawsuit initially brought by the Company against Deborah T. Kearns, Alan G. Carnrite, the Estate of Laurel Dell Manning, and David R. Watkins, who were the former shareholders of Sterling Consulting Group, Inc. Ms. Kearns and Mr. Carnrite filed

a counterclaim asserting various causes of action against the Company and two of its officers. The lawsuit was settled by payment by the Company of \$1.3 million to Ms. Kearns and \$0.1 million to Mr. Carnrite, no payment by Ms. Kearns or Mr. Carnrite and no admission of liability or wrongdoing by any party in connection with any claims or causes of action in the lawsuit.

In addition, from time to time, we are party to various other lawsuits and claims in the ordinary course of business. While the outcome of those lawsuits or claims cannot be predicted with certainty, we do not believe that any of those lawsuits or claims will have a material adverse effect on the Company.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Executive Officers of the Registrant

At February 1, 2000, the Registrant had the following executive officers:

Mitchell H. Saranow, 54, has served as Chairman of the Board and co-CEO of the Company since November 1999. He has served as one of our directors since 1996. Mr. Saranow has served as Chairman of The Saranow Group L.L.C. and its affiliated companies since October 1984. He founded Fluid Management, L.P. in April 1987 and served as Chairman and Chief Executive Officer until January 1997. Mr. Saranow also serves on the boards of Lawson Products, Mid-Atlantic CATV, ELF Machinery, L.L.C., and HyperLOCK Technologies.

John J. Reed, 45, has served as Vice-Chairman and co-CEO of the Company since November 1999. He was appointed a director of the Company on November 21, 1999. Prior to being named Vice-Chairman and co-CEO, Mr. Reed was the Executive Managing Director of the Company's Management Consulting practice. From 1988 until 1999, Mr. Reed was President of Reed Consulting Group, which the Company acquired in August 1997.

Carl S. Spetzler, 58, has served as President and co-CEO of the Company since November 1999. He was appointed a director of the Company on November 21, 1999. Prior to being named President and co-CEO, Dr. Spetzler was the Executive Managing Director of the Company's Strategic Consulting practice. From 1986 until 1999, Dr. Spetzler was the President of Strategic Decisions Group, which the Company acquired in February 1999.

James F. Hillman, 42, has served as the Chief Financial Officer and Treasurer of the Company since December 1999. From May 1999 through November 1999, he was President of Azimuth Consulting LLC. Mr. Hillman had previously served as the Company's Chief Financial Officer and Treasurer from June 1996 through April 1999. From 1988 until he joined the Company in 1996, he was with the Ameritech Corporation, most recently as the Chief Financial Officer of Ameritech Monitoring Services, Inc. Mr. Hillman is a certified public accountant.

Philip P. Steptoe, 48, has served as the Company's Vice President, Secretary and General Counsel since February 2000. Previously, Mr. Steptoe was a partner with the national law firm of Sidley & Austin. During 1994-1995 he served for four months as Acting General Counsel for Orange and Rockland Utilities, Inc., a New York electric and gas utility. Prior to joining Sidley & Austin in 1988, he was an associate and later a partner in the Chicago law firm of Isham, Lincoln & Beale.

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters.

Market Information

The shares of Common Stock of the Company are traded on the New York Stock Exchange (the "NYSE") under the symbol "NCI."

The following table sets forth, for the periods indicated, the high and low sale prices per share. Sales prices for periods beginning July 27, 1999 are as reported on the NYSE Composite Tape. Prior to July 27, 1999 the Company's Common Stock was traded on the Nasdaq National Market under the symbol "METZ" and prices for such periods are as as reported on the Nasdaq National Market.

	<u>High</u>	<u>Low</u>
1999		
Fourth quarter	\$48.50	\$ 8.69
Third quarter	\$54.25	\$26.13
Second quarter	\$36.13	\$22.81
First quarter	\$52.00	\$28.44
1998		
Fourth quarter	\$49.00	\$28.88
Third quarter	\$37.75	\$27.25
Second quarter	\$36.63	\$24.25
First quarter	\$33.92	\$24.00

Holder

As of March 6, 2000, there were approximately 244 holders of record of shares of common stock of the Company.

Distributions

The Company has not paid any cash dividends since its organization and does not anticipate that it will make any such distributions in the foreseeable future.

Sale of Unregistered Securities

Within the past three years, we have issued the following unregistered securities:

<u>Date</u>	<u>Type of Securities</u>	<u>Number of Shares</u>	<u>Purchaser</u>	<u>Consideration(1)</u>	<u>Exemption Claimed</u>
January 1, 1997	Common Stock	63,272	Former stockholders of L.E. Burgess Consultants, Inc.	All outstanding shares of L.E. Burgess Consultants, Inc.	Section 4(2)
July 31, 1997	Common Stock	3,205,767	Former stockholders of Resource Management International, Inc.	All outstanding shares of Resource Management International, Inc.	Section 4(2)
December 1, 1997	Common Stock	578,727	Former stockholders of Sterling Consulting Group, Inc.	All outstanding shares of Sterling Consulting Group, Inc.	Section 4(2)
December 1, 1997	Common Stock	45,000	Former stockholders of Reed-Stowe & Co., Inc.	All outstanding shares of Reed-Stowe & Co., Inc.	Section 4(2)
April 3, 1998	Common Stock	137,931	Former stockholders of AUC Management Consultants, Inc.	All outstanding shares of AUC Management Consultants, Inc.	Section 4(2)
April 3, 1998	Common Stock	51,562	Former stockholders of Hydrologic Consultants Inc. of California.	All outstanding shares of Hydrologic Consultants Inc. of California.	Section 4(2)
June 1, 1998	Common Stock	9,200	Former members of The VisionTrust Marketing Group, LLC	All membership interest of The VisionTrust Marketing Group, LLC	Section 4(2)
August 31, 1998	Common Stock	5,596,488	Former members of Peterson Consulting LLC	All outstanding membership interest of Peterson Consulting LLC	Section 4(2)
August 31, 1998	Common Stock	616,737	Former stockholders of Saraswati Systems Corporation	All outstanding shares of Saraswati Systems Corporation	Section 4(2)
August 31, 1998	Common Stock	103,900	Former stockholders of Applied Health Outcomes, Inc.	All outstanding shares of Applied Health Outcomes, Inc.	Section 4(2)
February 7, 1999	Common Stock	2,437,223	Former stockholders of Strategic Decisions Group	All outstanding shares of Strategic Decisions Group	Section 4(2)
March 31, 1999	Common Stock	952,227	Former stockholders of Triad International, Inc.	All outstanding shares of Triad International, Inc.	Section 4(2)
March 31, 1999	Common Stock	670,592	Former stockholders of GeoData Solutions, Inc.	All outstanding shares of GeoData Solutions, Inc.	Section 4(2)
March 31, 1999	Common Stock	234,109	Former stockholders of Dowling Associates, Inc.	All outstanding shares of Dowling Associates, Inc.	Section 4(2)

(1) Does not take into account assumed debt or cash paid to dissenting shareholders or for fractional shares.

Item 6. Selected Financial Data

The following financial and operating data should be read in conjunction with the information set forth under “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the consolidated financial statements of the Company and related notes thereto appearing elsewhere in this report.

	Years Ended December 31, (1)				
	1999	1998	1997	1996	1995
Statement of Operations Data:					
Revenues	\$ 397,694	\$287,626	\$228,731	\$181,375	\$154,426
Cost of services	266,080	174,175	145,144	117,559	99,879
Gross profit	131,614	113,451	83,587	63,816	54,547
General and administrative expenses(2)	107,274	62,093	55,579	48,031	53,930
Amortization	24,300	—	—	—	—
Merger related costs and restructuring charges (benefit)	(206)	12,778	1,312	—	—
Stock option compensation expense	3,850	—	—	—	—
Operating income (loss)	(3,604)	38,580	26,696	15,785	617
Other expense (income), net(2)	2,191	(2,638)	(1,205)	332	(5,270)
Income (loss) before income tax expense	(5,795)	41,218	27,901	15,453	5,887
Income tax expense(3)	8,827	25,637	9,237	97	480
Net income (loss)	\$ (14,622)	\$ 15,581	\$ 18,664	\$ 15,356	\$ 5,407
Net income (loss) per basic share	\$ (.35)	\$ 0.43	\$ 0.56	\$ 0.47	\$ 0.17
Net income (loss) per diluted share	\$ (.35)	\$ 0.41	\$ 0.55	\$ 0.47	\$ 0.17
As of December 31, (1)					
	1999	1998	1997	1996	1995
Balance Sheet Data:					
Cash and cash equivalents	\$ 42,345	\$119,704	\$ 45,972	\$ 33,859	\$ 1,999
Working capital	67,598	146,509	58,708	45,551	11,112
Total assets	414,676	230,517	125,827	94,542	52,280
Long-term debt, less current portion	—	—	319	1,561	1,202
Total stockholders’ equity	\$300,669	\$164,904	\$ 69,215	\$ 50,686	\$ 12,558

- (1) The amounts above have been restated and reclassified as described in Note 3 of Notes to Consolidated Financial Statements. Certain billable expenses which had previously been presented net of related revenues have been reclassified. As a result, both revenue and cost of sales for the years 1998, 1997, 1996 and 1995 have increased by \$13.9 million, \$12.9 million, \$12.7 million and \$13.9 million, respectively.
- (2) For the year ended December 31, 1995, general and administrative expenses include \$4.3 million reported by Peterson Consulting LLC for a restructuring charge related to the settlement of obligations under non-cancelable operating leases and other moving and transition costs. Other income for the year ended December 31, 1995 includes an extraordinary gain of \$5.7 million recorded by Peterson in connection with the extinguishment of certain other debt obligations.
- (3) During the periods presented, certain of our operating subsidiaries were entities not subject to federal income taxation. The provision for income taxes for the year ended December 31, 1998 reflects a one-time, non-cash charge of \$7.2 million resulting from the conversion of Peterson from the modified cash basis to the accrual basis for tax purposes.

PART II

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Management's Discussion and Analysis of Financial Condition and Results of Operations relates to the Consolidated Financial Statements included in this annual report on Form 10-K.

Overview

We are a nationwide provider of consulting services to electric and gas utilities, insurance companies and pharmaceutical companies, as well as other Fortune 100 companies. We derive substantially all of our revenues from fees for professional services. Over the last three years, the substantial majority of our revenues have been generated under standard hourly or daily rates billed on a time-and-expenses basis. Our clients are typically invoiced on a monthly basis with revenue recognized as the services are provided.

Our most significant expenses are project personnel costs, which consist of consultant salaries and benefits, and travel-related direct project expenses. We typically employ our project personnel on a full-time basis, although we supplement our project personnel through the use of independent contractors. We retain contractors for specific client engagements on a task-specific, per diem basis during the period their expertise or skills are required. We believe that retaining contractors on a per-engagement basis provides us with greater flexibility in adjusting project personnel levels in response to changes in demand for our services.

Acquisitions

As part of our growth strategy, we expect to continue to pursue complementary acquisitions to expand our geographic reach, expand the breadth and depth of our service offerings and enhance our consultant base. In furtherance of this growth strategy, we acquired twenty-four consulting firms since our initial public offering in October 1996.

During 1997, we acquired five companies: Resource Management International, Inc. (RMI), Reed Consulting Group, Inc. (Reed), Sterling Consulting Group, Inc. (Sterling), Reed-Stowe & Co., Inc. (RSC), and L.E. Burgess Consultants, Inc. (Burgess). These transactions were accounted for as poolings of interests. The Company's consolidated financial statements have been restated as if RMI, Reed, Sterling and RSC had been combined for all periods presented. The stockholders' equity and the operations of Burgess were not significant in relation to those of the Company. As such, the Company recorded the Burgess transaction by restating stockholders' equity as of the date of the acquisition without restating prior period financial statements.

RMI. As of July 31, 1997, we acquired substantially all of the common stock of RMI in exchange for 3.2 million shares of our common stock (valued at the time of closing at approximately \$75.3 million) and acquired the remaining minority interest in exchange for cash. RMI, based in Sacramento, California, is a provider of consulting services to gas, water, and electric utilities, with operations in the western and eastern United States and international marketplace. RMI's broad range of engineering, technical and economic regulatory services complemented our management consulting and information technology services.

Reed. As of August 15, 1997, we acquired substantially all of the common stock of Reed in exchange for 0.8 million shares of our common stock (valued at the time of closing at approximately \$17.6 million) and acquired the remaining minority interest in exchange for cash. Reed, based in the Boston, Massachusetts area, provides strategic planning, operations management and economic and regulatory services to electric and natural gas utilities. Reed's operations expanded our services and client base in the northeast United States and internationally.

Other 1997 Acquisitions. We acquired all of the common stock of Burgess as of January 1, 1997, and all of the common stock of Sterling and of RSC as of December 1, 1997. In the aggregate for these three transactions, we issued 0.7 million shares of our common stock (valued at the time of closing at approximately \$18.5 million). The consulting operations of these three companies were complementary to our existing businesses and have been integrated within the operations of other existing or acquired companies.

During 1998, we acquired eight companies: LECG, Inc. (LECG), Peterson Consulting, LLC (Peterson), Saraswati Systems Corporation (SSC), Applied Health Outcomes, Inc. (AHO), AUC Management Consultants, Inc. (AUC), Hydrologic Consultants, Inc. of California (HCI), American Corporate Resources, Inc. (ACR), and The Vision Trust Marketing Group, LLC (VTM). These transactions were accounted for as poolings of interests. The Company's consolidated financial statements have been restated as if LECG, Peterson, SSC, AHO, AUC, and HCI had been combined for all periods presented. The stockholders' equity and the operations of ACR and VTM were not significant in relation to those of the Company. As such, the Company recorded the ACR and VTM transactions by restating stockholders' equity as of the dates of the acquisition without restating prior period financial statements.

LECG. As of August 19, 1998, we acquired substantially all of the common stock of LECG in exchange for 7.3 million shares of our common stock (valued at the time of closing at approximately \$228.9 million) and acquired the remaining minority interest in exchange for cash. LECG, based in the San Francisco, California area, is a provider of economic consulting and litigation support services. LECG's operations further increased our economic and regulatory expertise and expanded our presence in the telecommunications industry.

Peterson. As of August 31, 1998, we acquired substantially all of the common stock of Peterson in exchange for 5.6 million shares of our common stock (valued at the time of closing at approximately \$156.7 million) and acquired the remaining minority interest in exchange for cash. Peterson, based in the Chicago area, is a provider of information management services. Peterson's operations expanded our service offerings in claims management, litigation support, and information management.

Other 1998 Acquisitions. We acquired all of the common stock of AUC, HCI, ACR as of April 3, 1998 and all of the common stock of VTM as of June 1, 1998. We acquired all of the common stock of SSC and AHO as of September 1, 1998. In the aggregate for these six transactions, we issued 1.2 million shares of our common stock (valued at the time of closing at approximately \$35.3 million). The consulting operations of all six companies were complementary to our existing businesses and have been integrated within the operations of other existing or acquired companies.

1999 Acquisitions. During 1999, the Company completed eleven acquisitions (collectively, the "1999 Acquisitions"). The 1999 Acquisitions were accounted for by the purchase method of accounting and, accordingly, the results of operations have been included in the consolidated financial statements from the respective dates of acquisition. On February 7, 1999, the Company issued 2.4 million shares of common stock (valued at the time of closing at approximately \$123.7 million) for substantially all of the outstanding common stock of Strategic Decisions Group and acquired the remaining minority interest in exchange for cash. On March 31, 1999, the Company completed the acquisitions of all of the outstanding stock of Triad International, Inc., GeoData Solutions, Inc., and Dowling Associates, Inc. in exchange for 1.8 million shares of the Company's common stock (valued at the time of closing at approximately \$57.3 million). On September 30, 1999, the Company completed its acquisition of the business operations and certain assets of Penta Advisory Services LLC (Penta) and the stock of Scope International, Inc. (Scope) for a total cash purchase price of \$15.1 million. The purchase agreements for Penta and Scope also provide for additional payments, payable in cash or Company common stock, over the next two to five years contingent on future revenue growth and gross margin targets. The additional payments, if any, will be accounted for as additional goodwill. On October 1, 1999, the Company completed the acquisition of the stock of Brooks International AB, Brooks International Consulting OY, and Brooks International SPRL for an aggregate cash purchase price of \$3.3 million. On November 1, 1999, the Company completed the acquisition of the stock of The Barrington Consulting Group, Inc. (Barrington) in exchange for \$14.4 million in cash paid at closing and total deferred cash payments of \$7.8 million, payable in two equal annual installments. The purchase agreement for Barrington also provides for additional cash payments of up to \$7.8 million in the aggregate, which are contingent on continued employment with the Company of certain Barrington shareholders and are payable in cash in two annual installments. On December 1, 1999, the Company completed the acquisition of all of the assets of Glaze Creek Partners, LLC in exchange for \$0.8 million in cash. There were no pre-acquisition intercompany transactions between the Company and the 1999 Acquisitions.

An inability to effectively integrate the acquisitions or any companies acquired in the future may adversely affect our ability to bid successfully on engagements and to grow our business. Performance problems or dissatisfied clients at one company could have an adverse effect on our reputation as a whole. If our reputation were damaged, for those or other reasons, this could make it more difficult to market our services or to acquire additional companies in the future. In addition, acquired companies may not operate profitably.

Acquisitions also involve a number of additional risks, including, among others, the following:

- Diversion of management’s attention;
- Potential loss of key clients or personnel;
- Risks associated with unanticipated assumed liabilities and problems; and
- Risks of managing businesses or entering markets in which we have limited or no direct expertise.

We expect to continue to acquire companies as an element of our growth strategy. Acquisitions involve certain risks that could cause our actual growth to differ from our expectations. For example

- We may not be able to continue to identify suitable acquisition candidates or to acquire additional consulting firms on favorable terms.
- We compete with other companies to acquire consulting firms. We cannot predict whether this competition will increase. If competition does increase, there may be fewer suitable consulting firms available to be acquired and the price for suitable acquisitions may increase.
- We may not be able to integrate the operations (accounting and billing functions, for example) of businesses we acquire to realize the economic, operational and other benefits we anticipate.
- We may not be able to successfully integrate acquired businesses in a timely manner or we may incur substantial costs, delays or other operational or financial problems during the integration process.
- It may be difficult to integrate a business with personnel who have different business backgrounds and corporate cultures.

Results of Operations

The following table sets forth, for the periods indicated, selected statement of operations data as a percentage of revenues:

	Years Ended December 31,		
	1999	1998	1997
Revenues	100.0%	100.0%	100.0%
Cost of services	<u>66.9</u>	<u>60.6</u>	<u>63.5</u>
Gross profit	33.1	39.4	36.5
General and administrative expenses	26.9	21.6	24.3
Amortization expense	6.1	—	—
Merger-related costs and restructuring charges	—	4.4	0.5
Stock option compensation expense	<u>1.0</u>	<u>—</u>	<u>—</u>
Operating income	(0.9)	13.4	11.7
Other expense (income), net	<u>0.6</u>	<u>(0.9)</u>	<u>(0.5)</u>
Income before income tax expense	(1.5)	14.3	12.2
Income tax expense	<u>2.2</u>	<u>8.9</u>	<u>4.0</u>
Net income (loss)	<u>(3.7)%</u>	<u>5.4%</u>	<u>8.2%</u>

1999 Compared to 1998

Revenues. Revenues increased \$110.1 million, or 38%, to \$397.7 million in the year ended December 31, 1999 from \$287.6 million in 1998. The growth in revenue was primarily due to acquisitions, expansion of services provided to existing clients, engagements with new clients, and increased selling and business development efforts. During 1999, the Company made acquisitions consistent with its strategy of acquiring consulting companies that provide complementary services or broaden the Company's geographic presence. The 1999 Acquisitions had pre-acquisition revenues for 1999 and 1998 of \$39.4 million and \$115.0 million, respectively, which were not included in the Company's consolidated results of operations. Pro forma revenues, adjusted for the effect of the 1999 acquisitions, increased \$34.4 million, or 9%, to \$437.1 million in the year ended December 31, 1999 from \$402.7 million in 1998.

The Company's consolidated 1998 revenues included certain operations which were not reflected in 1999. The 1998 reported and pro forma revenues include revenues of \$5.3 million related to certain principals who departed from Peterson in July 1998 and \$3.4 million of revenues related to Insurance Data Resources, Inc., a subsidiary of Peterson, which was disposed of on September 1, 1998. Excluding the effects of the departed principals and the disposed operations, the revenue increase in 1999 would have been \$43.1 million, or 11%, to \$437.1 million from \$394.0 million in the prior year. Consulting engagements with new clients and an increase in the average size of client consulting engagements contributed \$34.6 million and \$8.5 million, respectively, of the \$43.1 million of organic revenue growth in 1999.

Gross Profit. Gross profit consists of revenues less cost of services, which includes consultant compensation and benefits and direct project-related expenses. Gross profit increased \$18.1 million, or 16%, to \$131.6 million in 1999 from \$113.5 million in 1998. Higher 1999 revenues would have resulted in a \$43.4 million increase in gross profit had 1999 gross profit margins as a percentage of revenue been consistent with those in 1998. However, the gross margin in 1999 declined to 33.1% of revenue from 39.4% in 1998. The decline in gross margin in 1999 was primarily due to higher consultant compensation of \$23.1 million.

General and Administrative Expenses. General and administrative expenses include facilities costs, salaries and benefits of management and support personnel, allowances for uncollectible accounts receivable, depreciation expense, outside professional fees, and all other corporate support costs. General and administrative expenses for 1999 increased \$45.2 million to \$107.3 million from \$62.1 million in 1998. The \$45.2 million increase in general and administrative expenses in 1999 is comprised of: \$10.6 million in facilities costs, \$2.3 million in personnel related expenses, \$12.8 million in allowances for uncollectible accounts receivable, \$8.8 million in depreciation expense, \$7.1 million in professional fees, and \$3.6 million in other corporate support costs. In total, general and administrative expenses as a percentage of revenue increased to 27.0% in 1999 from 21.6% in 1998. This higher level of expenses as a percentage of revenue in 1999 represents approximately \$21.4 million of growth in expenses in excess of the rate of growth in revenues. The incremental \$21.4 million of general and administrative expenses is the result of \$0.9 million in higher facilities costs, \$11.8 million in higher allowances for uncollectible accounts receivable established in the fourth quarter of 1999, \$6.3 million in higher depreciation expense principally from impairments of certain fixed assets, \$5.7 million in higher professional fees primarily related to litigation, partially offset by \$3.3 million in lower personnel related expenses.

Amortization Expense. The excess of cost over the net assets acquired for the 1999 Acquisitions of approximately \$226.4 million has been recorded as intangible assets, including goodwill, and is being amortized on a straight-line basis over 7 years. The \$24.3 million non-cash expense recorded in 1999 represents the pro rata amortization from the respective acquisition dates through December 31, 1999. Amortization would have been approximately \$32.4 million had the 1999 Acquisitions occurred as of January 1, 1999.

Merger Related Cost and Restructuring Charges (Benefit). In the third quarter of 1998, the Company incurred merger-related costs of \$12.8 million related to the acquisitions of LECG and Peterson, which were accounted for as poolings of interests. These costs included legal, accounting and other transaction related fees and expenses, as well as accruals to consolidate certain facilities. The Company has reviewed the merger-related accruals and determined that certain amounts previously accrued are no longer necessary given subsequent

acquisition activity and changes in the Company's organizational structure. The results of operations for the year ended December 31, 1999 reflect a benefit of \$1.4 million for the reversal of the previously accrued amounts. The Company recognized \$1.2 million of expense in 1999 for employee separations associated with consolidation of certain accounting and human resources functions. In July 1999, the Company announced a restructuring initiative and offered involuntary severance packages to 73 employees in the administrative, accounting and human resources functions.

Stock Option Compensation Expense. The Company recorded \$3.5 million for stock option compensation expense in 1999 attributable to 0.3 million option grants to a total of sixteen individuals which were issued at prices below fair market value. The amount charged to expense was calculated using the intrinsic value method for employees and the Black-Scholes option pricing model for non-employees and approximates the aggregate dollar amount by which the grant prices of the options differ from the market prices as of the dates for which the Company has independent evidence to support the issuance of the options. The Company recorded an additional \$0.4 million of stock option compensation expense to amortize the value of certain options retained by a former employee upon separation from the Company.

Other Income (Expense), Net. Other income (expense), net includes interest expense, interest income and other non-operating income and expenses. For 1999, the Company incurred a net non-operating expense of \$2.2 million, which represented \$4.8 million of net incremental expense from the \$2.6 million other income realized in 1998. The incremental expense was principally the result of a \$5.3 million charge to earnings in 1999 to reflect the likely impairment in the value of certain loans receivable from shareholders. This incremental expense was partially offset by higher interest income in 1999.

Income Tax Expense. Income tax expense decreased \$16.8 million to \$8.8 million for 1999 from \$25.6 million in 1998. The Company's results of operations in 1999 included \$24.3 million of non-cash, non-deductible amortization expenses resulting from the 1999 acquisitions and \$3.9 million of non-cash, non-deductible stock options compensation expense. Excluding the effect of these non-deductible items, the effective tax rate for 1999 would have been 39.5%. The Company's effective income tax rate for 1998 would have been 39.8% excluding the effect of the one-time, non-cash charge to income tax expense of \$7.2 million related to the conversion of Peterson from the modified cash basis to the accrual basis of accounting for tax purposes and the effect of certain merger-related costs resulting from the mergers completed during the third quarter of 1998 that are not tax deductible.

Net Income (Loss). The Company's 1999 net loss of \$14.6 million represents a \$30.2 million decline from the 1998 net income of \$15.6 million. Higher 1999 revenues resulted in a \$18.1 million increase in gross profits over the prior year, which was more than offset by increases of \$45.2 million in general and administrative expense, \$24.3 million in amortization expenses, \$3.9 million in stock option compensation expense and \$4.8 million of other non-operating expenses. These expense increases were partially offset by \$16.8 million in lower income tax expenses and \$13.0 million in lower merger-related costs.

1998 Compared to 1997

Revenues. Revenues increased \$58.9 million, or 26%, to \$287.6 million in 1998 from \$228.7 million in 1997 due to continued strong demand for management consulting services, and increased selling and business development efforts. Selling and business development efforts in support of the Company's strategy to expand the client base and leverage existing client relationships resulted in \$57.2 million of the incremental \$58.9 million 1998 revenues. Engagements with new clients and an increase in the average size of client engagements contributed \$40.4 million and \$16.8 million of that total, respectively.

Gross Profit. Gross profit increased \$29.9 million, or 36%, to \$113.5 million in 1998 from \$83.6 million in 1997. Higher 1998 revenues contributed \$21.5 million of the increase in gross profit. The remaining \$8.4 million of the increase in gross profit reflects an increase in gross profit as a percentage of revenues to 39.4% in 1998 from 36.5% in 1997. The increase in the 1998 gross profit margin was the result of increased utilization of the Company's professional consultants coupled with higher average billing rates and a lower proportion of non-margin billable expenses to fee revenues.

General and Administrative Expenses. General and administrative expenses for the year ended December 31, 1998 increased \$6.5 million, or 12%, to \$62.1 million, which represented 21.6% of revenues, compared to \$55.6 million, or 24.3% of revenues, in the comparable 1997 period. The increase in general and administrative costs was primarily due to a \$3.3 million increase in facilities expenses, a \$1.8 million increase in administrative salaries, and a \$1.3 million increase in incentive compensation. However, these expenses increased at a slower rate than the Company's revenues and overall volume of business, resulting in a 2.7% decrease in general and administrative expenses as a percent of revenue. This improvement is attributable to increased efficiencies in certain support functions (i.e., human resources, benefits administration and accounting), improved economies of scale and the closing of certain duplicate facilities at the beginning of 1998.

Merger-Related Cost and Restructuring Charges. Merger-related costs increased \$11.5 million to \$12.8 million in 1998 from \$1.3 million in 1997. During 1998, the Company incurred merger-related costs of \$12.8 million related to the acquisitions of LECG and Peterson, which were accounted for as poolings of interests. These costs include legal, accounting and other merger-related fees and expenses, as well as accruals to consolidate certain facilities. In the prior year period, the Company incurred legal, accounting and other merger-related fees and expenses of \$1.3 million related to the acquisitions of RMI and Reed, which were accounted for as poolings of interests. The increased direct merger-related costs in 1998 were the result of the greater size and complexity of the 1998 transactions.

Other Income, Net. For the fiscal year ended December 31, 1998, other income, net increased \$1.4 million to \$2.6 million from \$1.2 million for 1997. This increase was largely the result of higher interest income due to larger average cash balances outstanding during the period. The larger average cash balance in 1998 was largely the result of \$86.4 million in net proceeds from two offerings of the Company's common stock supplemented by \$21.2 million of operating cash flows and \$10.6 million of cash inflow primarily from employee stock option exercises. These sources of cash were partially offset by \$13.6 million of capital spending, \$18.9 million of cash used to acquire certain minority interests in business combinations, \$8.2 million of payments to retire pre-existing short-term debt of acquired companies, and \$6.1 million in payments of pre-acquisition undistributed earnings of purchased companies.

Income Tax Expense. Income tax expense increased \$16.4 million to \$25.6 million in 1998 from \$9.2 million in 1997. The Company's effective income tax rate was 62.2% for the year ended December 31, 1998. The effective rate for this period would have been 39.8%, excluding the effect of the one-time, non-cash charge to income tax expense of \$7.2 million related to the conversion of Peterson from the modified cash basis to the accrual basis of accounting for tax purposes and the effect of certain merger-related expenses resulting from the acquisitions of LECG and Peterson that are not tax deductible. The Company's effective income tax rate was 33.1% for the year ended December 31, 1997. The effective rate would have been 38.2%, including federal and certain state income taxes that would have been required had all the Company's subsidiaries been taxable entities during this period.

Net Income. Net Income decreased approximately \$3.1 million to \$15.6 million in 1998 from \$18.7 million in 1997. Higher 1998 revenues resulted in a \$29.9 million increase in gross profits over the prior year. However, the higher level of 1998 gross profits was offset by a \$6.5 million increase in general and administrative expenses, a \$11.5 million increase in merger-related costs, and a \$16.4 million increase in income tax expense. An increase in other income in 1998 of \$1.4 million accounted for the remainder of the change in net income between the periods.

Unaudited Quarterly Results

The following table sets forth certain unaudited quarterly operating information. These data have been prepared on the same basis as the audited financial statements contained elsewhere in this Form 10-K and include all normal recurring adjustments necessary for the fair presentation of the information for the periods presented, when read in conjunction with the Company's Consolidated Financial Statements and related Notes thereto. Results for any previous fiscal quarter are not necessarily indicative of results for the full year or for any future quarter.

	Quarters Ended							
	Mar. 31, 1998	June 30, 1998	Sept. 30, 1998	Dec. 31, 1998	Mar. 31, 1999	June 30, 1999	Sept. 30, 1999	Dec. 31, 1999
	(In thousands, except per share amounts)							
Revenues	\$66,134	\$70,231	\$73,967	\$77,294	\$84,388	\$104,732	\$107,452	\$101,123
Cost of services	41,254	42,254	44,302	46,364	50,418	59,118	61,735	94,809
Gross profit	24,880	27,977	29,665	30,930	33,970	45,614	45,717	6,314
General and administrative expenses	16,355	18,232	13,552	13,955	15,343	20,964	21,077	49,890
Amortization expense	—	—	—	—	2,800	6,830	6,830	7,840
Merger-related costs and restructuring charges	—	—	12,778	—	—	—	(206)	—
Stock option compensation expense	—	—	—	—	1,698	532	1,063	557
Operating income (loss)	8,525	9,745	3,335	16,975	14,129	17,288	16,953	(51,973)
Other (income) expense, net	(550)	(791)	(523)	(773)	(1,115)	(1,037)	(1,218)	5,561
Income (loss) before income tax expense	9,075	10,536	3,858	17,748	15,244	18,325	18,171	(57,534)
Income tax expense (benefit)	3,773	4,215	10,680	6,968	8,020	10,186	10,310	(19,689)
Net income (loss)	\$ 5,302	\$ 6,321	\$ (6,822)	\$10,780	\$ 7,224	\$ 8,139	\$ 7,861	\$ (37,845)
Net income (loss), per diluted share	\$ 0.15	\$ 0.17	\$ (0.19)	\$ 0.28	\$ 0.17	\$ 0.19	\$ 0.17	\$ (0.91)
Diluted shares	36,477	37,752	36,610	39,093	41,786	43,508	45,357	41,798

Revenues and operating results fluctuate from quarter to quarter as a result of a number of factors, including the significance of client engagements commenced and completed during a quarter, the number of business days in a quarter and employee hiring and utilization rates. The timing of revenues varies from quarter to quarter due to factors such as the Company's sales cycle, the ability of clients to terminate engagements without penalty, the size and scope of assignments and general economic conditions. Because a significant percentage of the Company's expenses are relatively fixed, a variation in the number of client assignments or the timing of the initiation or the completion of client assignments can cause significant variations in operating results from quarter to quarter. Furthermore, the Company has on occasion experienced a seasonal pattern in its operating results, with a smaller proportion of the Company's revenues and lower operating income occurring in the fourth quarter of the year or a smaller sequential growth rate than in other quarters.

During the quarter ended December 31, 1999, the Company incurred certain pre-tax expenses which varied significantly from expense levels recorded in prior interim periods during the year. The aggregate of these expenses amounted to \$62.6 million and consisted of the following: \$28.5 million of additional costs of sales, \$28.2 million of incremental general and administrative expenses, and \$5.9 million of other incremental non-operating expenses. The higher fourth quarter cost of sales was principally due to \$26.3 million of incremental compensation expense accruals to provide for competitive levels of incentive compensation and promote employee retention. Fourth quarter general and administrative expenses included the following significant incremental expenses: \$12.8 million of allowances for uncollectible accounts receivable; \$5.5 million of write-downs of certain fixed assets, \$5.5 million of professional fees and other costs related to settlement of certain then outstanding litigation; \$1.2 million of compensation expense to provide for competitive levels of incentive compensation and promote employee retention; and \$0.5 million of stock option compensation expense. The increase in non-operating expenses for the fourth quarter was primarily the result of a loss contingency accrued at December 31, 1999 in the amount of \$5.3 million, related to the impairment of notes receivable from certain former company officers.

The following table sets forth select unaudited quarterly information as previously reported and as amended. The amended amounts have been restated to retroactively reflect the results of operations for certain business combinations completed in 1998 which were accounted for as poolings of interests. At the respective dates of acquisition, the Company had determined that the stockholders' equity and the results of operations of these businesses were not material, individually or in the aggregate, in relation to those of the Company. As such, the Company had recorded these combinations by restating stockholders' equity as of the effective date of each acquisition without restating prior period financial statements. However, based in part on comments received from the Securities and Exchange Commission, the Company has restated the financial statements for 1998 to reflect the results of operations of AUC, HCI, SSC, and AHO.

The amended amounts also incorporate certain reclassifications to conform the presentation of revenue and cost of sales for 1998 and previously issued interim 1999 periods to the 1999 presentation. Certain billable expenses which had previously been presented net of related revenues have been reclassified. The amended amounts for the first three quarters of 1999 also reflect adjustments to correct the application of certain accounting principles related to stock option compensation expense. See also Note 13, "Long-Term Incentive Plan".

	Quarters Ended						
	Mar. 31, 1998	June 30, 1998	Sept. 30, 1998	Dec. 31, 1998	Mar. 31, 1999	June 30, 1999	Sept. 30, 1999
	(In thousands, except per share amounts)						
Total revenue as previously reported	\$60,809	\$64,863	\$68,311	\$72,894	\$82,151	\$103,623	\$106,185
Retroactive effect of pooling accounting	2,854	2,269	1,721	—	—	—	—
Reclassifications	2,471	3,099	3,935	4,400	2,237	1,109	1,267
Revenues, as amended	<u>\$66,134</u>	<u>\$70,231</u>	<u>\$73,967</u>	<u>\$77,294</u>	<u>\$84,388</u>	<u>\$104,732</u>	<u>\$107,452</u>
Gross profit, as previously reported	\$24,786	\$27,848	\$28,991	\$30,930			
Retroactive effect of pooling accounting	94	129	673	—			
Gross profit, as amended	<u>\$24,880</u>	<u>\$27,977</u>	<u>\$29,664</u>	<u>\$30,930</u>			
Operating income, as previously reported	\$ 8,899	\$10,101	\$ 2,909	\$16,975	\$15,827	\$ 17,820	\$ 18,016
Retroactive effect of pooling accounting	(374)	(356)	426	—	—	—	—
Stock option compensation expense	—	—	—	—	(1,698)	(532)	(1,063)
Operating income (loss), as amended	<u>\$ 8,525</u>	<u>\$ 9,745</u>	<u>\$ 3,335</u>	<u>\$16,975</u>	<u>\$14,129</u>	<u>\$ 17,288</u>	<u>\$ 16,953</u>
Net income (loss) as previously reported	\$ 5,658	\$ 6,658	\$(6,973)	\$10,780	\$ 8,922	\$ 8,671	\$ 8,924
Retroactive effect of pooling accounting	(356)	(337)	151	—	—	—	—
Stock option compensation expense	—	—	—	—	(1,698)	(532)	(1,063)
Net income (loss), as amended	<u>\$ 5,302</u>	<u>\$ 6,321</u>	<u>\$(6,822)</u>	<u>\$10,780</u>	<u>\$ 7,224</u>	<u>\$ 8,139</u>	<u>\$ 7,861</u>
Net income (loss) per share as previously reported	\$ 0.16	\$ 0.18	\$ (0.19)	\$ 0.28	\$ 0.21	\$ 0.20	\$ 0.20
Retroactive effect of pooling accounting	(0.01)	(0.01)	—	—	—	—	—
Stock option compensation expense	—	—	—	—	(0.04)	(0.01)	(0.03)
Net income (loss) per diluted share, as amended	<u>\$ 0.15</u>	<u>\$ 0.17</u>	<u>\$ (0.19)</u>	<u>\$ 0.28</u>	<u>\$ 0.17</u>	<u>\$ 0.19</u>	<u>\$ 0.17</u>
Diluted shares, as previously reported	35,566	37,031	36,129				
Retroactive effect of pooling accounting	911	721	481				
Diluted shares, as amended	<u>36,477</u>	<u>37,752</u>	<u>36,610</u>				

Liquidity and Capital Resources

Net cash provided by operating activities was \$17.4 million for the year ended December 31, 1999. During the year, the primary sources of cash provided by operating activities was net income adjusted for non-cash charges of depreciation, amortization, stockholder notes impairment provision and stock compensation expense. Net income adjusted for these non-cash charges was \$32.5 million. Operating cash flow was also positively affected by increases in accrued compensation and project costs of \$10.6 million and other current liabilities of \$3.4 million. Operating cash flow was negatively affected by the increase in accounts receivable of \$19.5 million, the decrease in income taxes payable of \$13.0 million and the non-cash charge relating to deferred income taxes of \$11.0 million.

The Company used \$18.6 million for capital spending to support growth in personnel and services. These investments included leasehold improvements, furniture and equipment for new leased facilities, additional computer and related equipment for information management consulting services and the purchase and implementation of enterprise financial and project software system. The Company used \$42.1 million in cash during 1999 in conjunction with the 1999 Acquisitions.

Net cash used in financing activities was \$32.5 million in 1999. During the year, the Company received net cash and related tax benefits of \$17.4 million from transactions related to stock option exercises and employee stock purchases. In addition, the Company received proceeds of \$10.0 million from borrowings on the line of credit facility. The Company used \$40.0 million to purchase treasury shares in 1999. Borrowing by stockholders used approximately \$17.0 million of funds during the year.

As of December 31, 1999, the Company had no significant commitments for capital expenditures, except for those related to rental expense under operating leases and related leasehold improvements. The total amount of operating lease payments in 2000 is expected to be approximately \$15.2 million. The total amount of capital spending in the year 2000 related to leasehold improvements is expected to be approximately \$6.9 million.

The Company had approximately \$42.3 million in cash and cash equivalents at December 31, 1999, resulting principally from cash flows from operations and the various public stock offerings during the previous three years. The company believes that the current cash and cash equivalents, the future cash flows from operations and the \$50 million line of credit facility will provide adequate cash to fund anticipated short-term and long-term cash needs from normal operations. In the event the Company were to make significant cash expenditures in the future for major acquisitions or other non-operating activities, the Company would seek additional debt or equity financing, as appropriate. The Company had no plans or intentions for such expenditures as of December 31, 1999.

Recently Issued Financial Accounting Standards

The Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 133, Accounting for Derivative Instruments and Hedging Activities in June 1998. This statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. This statement is effective for fiscal years beginning after June 15, 1999. The Company does not currently have any derivative instruments or complete any hedging activities. The adoption of this standard is not expected to be significant.

Item 7A. Quantitative and Qualitative Disclosures About Market Risks

The Company's primary exposure to market risks relates to changes in interest rates associated with its investment portfolio and its borrowings under the line of credit. The Company's general investment policy is to

limit the risk of principal loss by limiting market and credit risks. As of December 31, 1999, the Company's investments were primarily limited to fully collateralized, Double-A or Triple-A rated securities with maturity dates of 90 days or less. If interest rates average 25 basis points less in fiscal year 2000, than they did in 1999, the Company's interest income would be decreased by \$0.1 million. This amount is determined by considering the impact of this hypothetical interest rate on the Company's investment portfolio at December 31, 1999. The Company does not expect any loss with respect to its investment portfolio. The Company's market risk associated with its line of credit relates to changes in interest rates. Borrowings under the line of credit bear interest, at the Company's option, based on either the London Interbank Offered Rate (LIBOR) or the primate rate. If interest rates average 25 basis points higher in 2000, than they did in 1999, the Company's interest expense would increase by less than \$.1 million. This amount is determined based on the amount of short-term debt at December 31, 1999. The Company does not currently have any long-term debt, interest rate derivatives, forward exchange agreements, firmly committed foreign currency sales transactions, or derivative commodity instruments.

The Company operates in foreign countries which exposes it to market risk associated with foreign currency exchange rate fluctuations; however, such risk is immaterial at this time to the Company's consolidated financial statements.

Item 8. Consolidated Financial Statements and Supplemental Data.

The Consolidated Financial Statements of the Company are annexed to the report as pages F-1 through F-22. An index to such materials appears on page F-1.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

PART III

Item 10. Directors and Executive Officers of the Registrant.

The Board of Directors is divided into three classes, with a class of directors elected each year for a three-year term.

A listing of the principal occupation, other major affiliations and age of the directors of Navigant Consulting is set forth below:

Directors Whose Terms Continue Until the Annual Meeting of Shareholders in 2000:

Mitchell H. Saranow, 54, has served as one of our directors since 1996 and became Chairman of the Board and Co-Chief Executive Officer in November 1999. Since 1984, Mr. Saranow has served as Chairman of The Saranow Group L.L.C. and its affiliated companies. He founded Fluid Management, L.P., the world's leading manufacturer of color formulation equipment, in April 1987 and served as Chairman and Chief Executive Officer until January 1997. From 1979 to 1983, Mr. Saranow was Vice President Finance and Chief Financial Officer of CFS Continental, then the nation's second largest food service distributor. Mr. Saranow also serves on the boards of Lawson Products, Inc., ELF Machinery, L.L.C., and BroadBridge Media, L.L.C.

Peter B. Pond, 55, has served as one of our directors since November 1996. He served as the Midwest Head of Investment Banking for Donaldson, Lufkin & Jenrette Securities Corporation from June 1991 to March 2000. Mr. Pond is a director of Maximus, Inc., a provider of program management and consulting services to state, county and local government health and human services agencies.

Directors Whose Terms Continue Until the Annual Meeting of Shareholders in 2001:

John J. Reed, 45, has served as our Vice-Chairman and Co-Chief Executive Officer since November 1999. He was appointed a director of the company on November 21, 1999. Prior to being named Vice-Chairman and

Co-Chief Executive Officer, Mr. Reed was the Executive Managing Director of our Management Consulting practice. From 1988 until 1999, Mr. Reed was President of Reed Consulting Group, which we acquired in August 1997.

James R. Thompson, 63, has served as one of our directors since August 1998. Governor Thompson was named Chairman of the Chicago law firm of Winston & Strawn in January 1993. He joined the firm in January 1991 as Chairman of the Executive Committee after serving four terms as Governor of the State of Illinois from 1977 until January 1991. Prior to his terms as Governor, he served as U.S. Attorney for the Northern District of Illinois from 1971 to 1975. Governor Thompson served as the Chief of the Department of Law Enforcement and Public Protection in the Office of the Attorney General of Illinois, as an Associate Professor at Northwestern University School of Law, and as an Assistant State's Attorney of Cook County. He is a former Chairman of the President's Intelligence Oversight Board. Governor Thompson is currently a member of the Boards of Directors of Union Pacific Resources, Inc., Prime Retail, Inc., American National Can Co., Metal Management, Inc., Prime Group Realty Trust, FMC Corporation, and Hollinger International. He serves on the Board of the Chicago Historical Society, the Art Institute of Chicago, the Museum of Contemporary Art, the Lyric Opera and the Illinois Math & Science Academy Foundation.

Samuel K. Skinner, 61, has served as a director since December 15, 1999. He currently serves as Co-Chairman of Hopkins & Sutter, a law firm based in Chicago. Mr. Skinner recently retired as President of the Commonwealth Edison Company and its holding company Unicom Corporation. Prior to joining Commonwealth Edison, he served as Chief of Staff to President George Bush. Prior to his White House service, Mr. Skinner served in the President's cabinet for nearly three years as Secretary of Transportation. From 1977 to 1989, Mr. Skinner practiced law as a senior partner in the Chicago law firm Sidley & Austin. From 1984 to 1988, while practicing law full time, he also served as Chairman of the Regional Transportation Authority of northeastern Illinois and was appointed by President Reagan as Chairman of the President's Commission on Organized Crime. From 1968 to 1975, Mr. Skinner served in the office of the United States Attorney for the Northern District of Illinois and in 1977, President Ford appointed him United States Attorney, one of the few career prosecutors ever to hold such position.

Directors Whose Terms Continue Until the Annual Meeting of Shareholders in 2002:

Carl S. Spetzler, 58, has served as our President and Co-Chief Executive Officer since November 1999. He was appointed a director of the company on November 21, 1999. Prior to being named President and Co-Chief Executive Officer, Dr. Spetzler was the Executive Managing Director of our Strategic Consulting practice. From 1986 until 1999, Dr. Spetzler was the President of Strategic Decisions Group, which we acquired in February 1999.

William M. Goodyear, 51, has served as a director since December 15, 1999. He is immediate past chairman and former Chief Executive Officer of Bank of America, Illinois. In addition, he was President of the Bank of America's Global Private Bank until January of 1999. He was Vice Chairman and a member of the Board of Directors of Continental Bank, prior to the 1994 merger between Continental Bank Corporation and BankAmerica Corporation. Mr. Goodyear joined Continental Bank in 1972 and subsequently held a variety of assignments including corporate finance, large corporate lending, trading and distribution. He was stationed in London from 1986 to 1991 where he was responsible for European and Asian Operations. Mr. Goodyear is currently a member of Chicago's Commercial Club, the board of Trustees for the Museum of Science and Industry and the finance council of the Archdiocese of Chicago. He is a member of the board of trustees of the University of Notre Dame, the Chicago Public Library Foundation and serves on the Rush-Presbyterian Hospital Board. Mr. Goodyear is a director of Equity Office Properties Trust where he is Chairman of its audit committee. He is an advisory director of Shorebank in Chicago and a member and director of the executive committee of Home Place of America, Inc.

Information as to our executive officers is provided under the caption "Executive Officers of the Registrant" under Item 4 of this Form 10-K. Officers of the company are elected annually for a term of one year.

Compliance with Section 16(a) of the Securities Exchange Act of 1934

Section 16(a) of the Securities Exchange Act of 1934 requires our directors and executive officers, and any persons who beneficially own more than ten percent of our common stock, to file with the SEC initial reports of ownership and reports of changes in ownership of common stock. To our knowledge, based solely on review of the copies of such reports sent to us and written representations that no other reports were required, we believe that during the year ended December 31, 1999, our directors, officers and ten percent shareholders complied with their Section 16(a) filing requirements, except that Messrs. Reed and Spetzler filed their Initial Statements of Beneficial Ownership on Form 3 late.

Item 11. Executive Compensation.

General

The following table sets forth compensation awarded or earned by our three Co-Chief Executive Officers, one other executive officer who earned more than \$100,000 during the year ended December 31, 1999 and two other executive officers who earned more than \$100,000 during that year but were not executive officers at December 31, 1999:

Summary Compensation Table

<u>Name and Principal Position</u>	<u>Annual Compensation</u>			<u>Long-Term Compensation</u>		
	<u>Year</u>	<u>Salary (\$)</u>	<u>Bonus (\$)</u>	<u>Other Annual Compensation (\$)</u>	<u>Securities Underlying Options (No. of Shares)</u>	<u>All Other Compensation</u>
Mitchell H. Saranow Chairman and Co-Chief Executive Officer(1)	1999	69,232	35,000	—	19,500	—
John J. Reed Vice Chairman and Co-Chief Executive Officer(2)	1997	145,000	217,861	—	—	204(9)
	1998	164,430	315,668	—	100,000	255(9)
	1999	246,474	363,525	—	50,000	908(9)
Carl S. Spetzler President and Co-Chief Executive Officer(3)	1999	311,058	298,942	—	108,895	2,516(9)
James F. Hillman Chief Financial Officer(4)	1997	206,250	—	625(7)	37,500	—
	1998	250,000	—	1,994,063(8)	75,000	204(9)
	1999	162,692	—	—	—	204(9)
Robert P. Maher Former Chairman, President and Chief Executive Officer(5)	1997	411,250	—	1,500(7)	150,000	—
	1998	462,060	—	—	375,000	717(9)
	1999	426,613	—	—	112,500	1,188(9)
Timothy D. Kingsbury Former Chief Financial Officer and Treasurer(6)	1997	223,958	85,619	4,500(7)	—	1,530(9)
	1998	225,000	—	4,500(7)	6,000	1,734(9)
	1999	240,625	87,500	—	144,000	324(9)

- (1) Mr. Saranow was elected to his positions as an executive officer in November 1999. Prior to that time he was a non-employee director of the company. See also the discussion of Mr. Saranow's employment agreement under "Employment Agreements," below.
- (2) Mr. Reed was elected to his positions in November 1999. Prior to that time he was an employee but not an executive officer of the company. Mr. Reed joined the company in August 1997 when it acquired Reed Consulting Group. See also the discussion of Mr. Reed's employment agreement under "Employment Agreements," below.

- (3) Mr. Spetzler was elected to his positions in November 1999. Prior to that time he was an employee but not an executive officer of the Company. Mr. Spetzler joined the company in February 1999 when it acquired Strategic Decisions Group. See also the discussion of Mr. Spetzler's employment agreement under "Employment Agreements," below.
- (4) Mr. Hillman has been our Chief Financial Officer and Treasurer from April 1996 to May 1999 and since November 1999. See also the discussion of Mr. Hillman's employment arrangement under "Employment Agreements," below.
- (5) Mr. Maher was our Chairman, President and Chief Executive Officer until he resigned in November 1999.
- (6) Mr. Kingsbury was our Chief Financial Officer and Treasurer from May 1999 until he resigned from those positions in November 1999. Before and after this period he has served as an employee but not an executive officer of the Company.
- (7) Represents matching payments and profit sharing under applicable 401(k) Plan.
- (8) Consists of compensation resulting from the exercise of stock options.
- (9) Represents earnings associated with group term life insurance.

Executive Option Grants

The following table sets forth the stock option grants we made to each of the named executive officers in 1999.

Options Grants in Fiscal 1999

Name	Individual Grants (1), (9)				
	Number of Securities Underlying Options Granted	Percent of Total Options Granted to Employees in Fiscal Year 1999	Exercise Price Per Share	Expiration Date	Grant Date Present Value (1)
Mitchell H. Saranow	19,500(2)	.44%	\$26.5625	6/30/2009	\$ 272,000
John J. Reed	50,000(3)	1.12%	\$30.5000	3/22/2009	\$ 802,000
Carl S. Spetzler	25,000(4)	.56%	\$26.5625	6/30/2009	\$ 349,000
	8,895(5)	.20%	\$30.5000	3/22/2009	\$ 143,000
	75,000(6)	1.67%	\$50.7500	2/7/2009	\$2,026,000
James F. Hillman	—	—	—	—	—
Robert P. Maher	112,500(7)	2.51%	\$26.5625	2/20/2002	\$1,571,000
Timothy D. Kingsbury	144,000(8)	3.21%	\$26.5625	6/30/2009	\$2,011,000

- (1) The fair value of the option grant is estimated as of the date of grant using the Black-Scholes option pricing model. The following assumptions were used

Expected Volatility	75%
Risk-free interest rate	5.5%
Dividend yield	0%
Expected life	3 years
- (2) The options were granted on July 1, 1999 at the fair market value of common stock on that date; 50% of these options become exercisable on July 1, 2001 and the remainder become exercisable 25% on July 1, 2002 and 25% on July 1, 2003.
- (3) The options were granted on March 23, 1999 at the fair market value of common stock on that date and become exercisable 50% on March 23, 2001, 25% on March 23, 2002 and 25% on March 23, 2003.
- (4) The options were granted on July 1, 1999 at the fair market value of common stock on that date and became exercisable 100% on February 8, 2000.

- (5) The options were granted on March 23, 1999 at the fair market value of common stock on that date and became exercisable 100% on March 23, 2000.
- (6) The options were granted on February 8, 1999 at the fair market value of common stock on that date; 33% of these options become exercisable on February 8, 2001 and the remainder become exercisable 33% on February 8, 2002 and 33% on February 8, 2003.
- (7) The options were granted on July 1, 1999 at the fair market value of common stock on that date; 37,500 of these options become exercisable on November 21, 2000. Pursuant to Mr. Maher's Consulting Agreement signed in November, 1999 he relinquished the remaining 75,000 options granted on July 1, 1999.
- (8) The options were granted on July 1, 1999 at the fair market value of common stock on that date; 50% of these options become exercisable on July 1, 2001 and the remainder become exercisable 25% on July 1, 2002 and 25% on July 1, 2003.
- (9) See also the discussion of options granted in January 2000 to Messrs. Saranow, Reed, Spetzler and Hillman under "Employment Agreements," below.

Option Exercises and Holdings

The following table sets forth the exercise of options during 1999 by the named executive officers and the number of options and approximate values for in-the-money options at December 31, 1999. Because the exercise price of all such stock options is greater than \$10.875 per share, the closing price of the common stock as reported by the New York Stock Exchange on December 31, 1999, the table shows that there were no in-the-money options at that date.

Name	Aggregated Option Exercises in 1999 and Fiscal Year End Option Values		Number of Shares Underlying Unexercised Options at Fiscal Year End(#)(3)		Value of Unexercised In-The-Money Options at Fiscal Year End	
	Shares Acquired on Exercise(#)	Value Realized(\$)	Exercisable	Unexercisable	Exercisable	Unexercisable
	Mitchell H. Saranow	0	\$0.00	24,750	75,250	\$0.00
John J. Reed	0	\$0.00	0	150,000	\$0.00	\$0.00
Carl S. Spetzler	0	\$0.00	0	108,895	\$0.00	\$0.00
James J. Hillman	—	—	—	—	—	—
Robert P. Maher	112,500	\$0.00	75,000	225,000	\$0.00	\$0.00
Timothy D. Kingsbury	0	\$0.00	0	150,000	\$0.00	\$0.00

Employment Agreements

In January 2000, the company entered into employment agreements with its three Co-Chief Executive Officers, Messrs. Saranow, Reed and Spetzler. Each agreement provides for a three year term ending November 12, 2002, an annual base salary of \$500,000 with annual increases in the discretion of the compensation committee, a maximum annual bonus opportunity of 100% of base salary and a target payment of 65% of the base salary. Each agreement also provides for a grant to the executive of an option to purchase 300,000 shares under the company's long-term incentive plan at an exercise price of \$10 per share, which option vests and becomes exercisable 50% on the date of grant, 25% six months after the date of grant and 25% 18 months after the date of grant (subject to immediate vesting in the event of a change of control, termination of the executive without cause (as defined in the agreement) or termination of the executive for good reason (as defined in the agreement)). (Because the date of grant is January 18, 2000, these options are not shown in the tables above.) Each agreement provides that if either the company terminates the executive's employment (other than for cause, death or disability), the executive terminates his employment for good reason or the executive terminates his employment after change of control for any reason, then the company will pay to the executive an amount equal to two times the sum of his base salary and most recent bonus. Each agreement also provides that if the executive's employment terminates because of the executive's death or disability, the company will pay to the executive an amount equal to his base salary and most recent bonus. If a payment or benefit received by the

executive would be subject to excise tax as a result of Section 280G of the Internal Revenue Code, the agreement provides for a reduction of the post-termination payments to the executive if, as a result of the excise tax, the net amount of post-termination payments retained by the executive (taking into account income and excise taxes) are increased by the reduction. In addition, the employment agreement with Mr. Saranow provides that he will be nominated to serve as a director of the company at the annual meeting of shareholders in 2000 and that he shall be required to devote a reasonable amount of his time (which shall be less than full-time) to the business and affairs of the company.

The company has employment agreements with other of its executive officers. The employment agreement with Mr. Steptoe, our Vice President, General Counsel and Secretary, provides for an annual base salary of \$250,000, a maximum annual bonus opportunity of 50% of base salary and a grant to Mr. Steptoe of an option to purchase 100,000 shares under the company's long-term incentive plan at an exercise price of \$9 per share, which option vests and becomes exercisable as to 25,000 of those shares six months after the date of grant and as to an additional 25,000 of those shares every six months thereafter (subject to immediate vesting in the event of a change of control). The agreement provides that if the company terminates Mr. Steptoe's employment without cause, the company will continue his base salary for six months. The arrangement with Mr. Hillman, our Chief Financial Officer, provides for an annual base salary of \$350,000, a maximum annual bonus opportunity of 50% of base salary and a grant to Mr. Hillman of an option to purchase 150,000 shares under the company's long-term incentive plan at an exercise price of \$10.125 per share, which option vests and becomes exercisable as to 100,000 of those shares on the date of grant and as to the remaining 50,000 of those shares one year after the date of grant. The arrangement also provides for payments to Mr. Hillman in consideration of his execution of a release of the company of \$200,000 in January 2000 and \$200,000 one year thereafter. If the company terminates Mr. Hillman's employment without cause, the company will continue his base salary for six months.

Director Compensation

Under our current long-term incentive plan, we grant each director not employed by us an option to purchase 3,000 shares of common stock for each year of the term to be served upon the director's initial election or re-election to the Board. Thus, a director elected to a three-year term receives 9,000 options. The options have an exercise price equal to the fair market value of the common stock on the date of grant and become exercisable in equal installments over the term to be served beginning on the first anniversary of the date of grant, so that 3,000 options become exercisable each year. From time to time, we also grant our non-employee directors additional options after reviewing the level of compensation other companies similarly situated to us pay their non-employee directors.

Beginning in January 2000, we also pay each Non-Employee Director an annual retainer of \$35,000 and a fee of \$1,500 for each Board meeting or Committee meeting attended. All directors are reimbursed for travel expenses incurred in connection with attending Board and Committee meetings.

Compensation Committee Interlocks and Insider Participation

Prior to December 1999 the Compensation Committee of our Board of Directors consisted of Messrs. Maher, Pond, Saranow and Thompson. Prior to his resignation in November, 1999, Mr. Maher was the Chairman and Chief Executive Officer of the company. In November 1999, Mr. Saranow was elected as our Chairman and Co-Chief Executive Officer. In December 1999 the Board appointed Messrs. Skinner and Goodyear as the sole members of the Compensation Committee. In February 2000 the Board reconstituted the Compensation Committee as the Compensation and Organization Committee. Messrs. Skinner and Goodyear continued as the sole members of this Committee.

Item 12. Security Ownership of Certain Beneficial Owners and Management

The following table sets forth certain information regarding the beneficial ownership of common stock as of April 14, 2000 by: (i) each person we know to own beneficially more than five percent of the outstanding

shares of common stock; (ii) each of our directors and nominees; (iii) each of the named executive officers; and (iv) all of our directors and executive officers as a group. We believe that each person named below has sole voting and investment power with respect to all shares of common stock shown as beneficially owned by such holder, subject to community property laws where applicable. Except where noted otherwise, the address of each person named below is care of our principal executive offices.

<u>Officers, Directors and 5% Shareholders</u>	<u>Shares Beneficially Owned(1)</u>	
	<u>Number</u>	<u>Percent</u>
Blum Capital Partners, L.P., Richard C. Blum Associates, Inc. and Richard C. Blum(2)	2,506,200	6.10%
Mitchell H. Saranow(3)	254,875	*
John J. Reed(4)	152,446	
Carl S. Spetzler(5)	323,435	*
James F. Hillman(6)	100,000	*
Peter B. Pond(7)	34,875	*
William M. Goodyear	0	*
Samuel K. Skinner	0	*
James R. Thompson(8)	3,000	*
Robert P. Maher(9)	170,481	*
Timothy D. Kingsbury	128,123	*
All current directors and executive officers as a group (9 persons) .	890,956	2.10%

*less than 1%

- (1) Applicable percentage of ownership as of April 14, 2000 is based upon approximately 41.3 million shares of common stock outstanding. Beneficial ownership is a technical term determined in accordance with the rules of the SEC. Beneficial ownership generally means that a shareholder can vote or sell the stock either directly or indirectly.
- (2) Based on information provided in the Schedule 13D filed by Blum Capital Partners, L.P., Richard C. Blum & Associates, Inc. and Richard C. Blum with the Securities and Exchange Commission on April 7, 2000, those persons share voting and dispositive power with respect to such shares. The address of each of those persons is 909 Montgomery Street, Suite 400, San Francisco, California 94133.
- (3) Includes 184,875 shares of common stock subject to options that are or become exercisable within 60 days of April 14, 2000.
- (4) Includes 150,000 shares of common stock subject to options that are or become exercisable within 60 days of April 14, 2000.
- (5) Includes 183,895 shares of common stock subject to options that are or become exercisable within 60 days of April 14, 2000.
- (6) Includes 100,000 shares of common stock subject to options that are or become exercisable within 60 days of April 14, 2000.
- (7) Includes 34,875 shares of common stock subject to options that are or become exercisable within 60 days of April 14, 2000.
- (8) Includes 3,000 shares of common stock subject to options that are or become exercisable within 60 days of April 14, 2000.
- (9) Includes 75,000 shares of common stock subject to options that are or become exercisable within 60 days of April 14, 2000. Mr. Maher's address is c/o Robert T. Markowski, Jenner & Block, One IBM Plaza, Chicago, Illinois 60611.

Item 13. Certain Relationships and Related Transactions

In April 1999, Mr. Maher, the company's Chairman and Chief Executive Officer at that time, borrowed \$2.7 million from the company so that he could exercise his then-vested options. Mr. Maher exercised all 112,500 of his then-vested options at an exercise price of \$24.00 per share. In August 1999, Mr. Maher borrowed an additional \$10 million from the company. The applicable interest rate for this loan was 5.75%, payable annually. In November 1999, the company received from Mr. Maher 605,684 shares of the company's common stock with a then market value of \$12.9 million as payment for the principal amount of the loans plus accrued interest.

Five non-employees related by blood or marriage to Mr. Maher received stock option grants. Mr. Maher has informed the company that each of these persons provided services to the company from time to time and received no other compensation for those services. In addition, one other individual not employed by the company, but who was an employee of an unrelated company owned or controlled by Mr. Maher, received stock option grants. Mr. Maher has informed the company that this individual provided certain services to the company from time to time. These persons are among sixteen as to whom the company has determined, based in part on the absence of contemporaneous documentation, that 0.3 million nonqualified options issued to a total of sixteen individuals were issued at prices below fair market value. The company recorded an expense in 1999 of \$3.5 million for stock option compensation expense attributable to such options issued to the sixteen individuals. Of the total stock option compensation expense of \$3.5 million, \$0.6 million is attributable to the first six persons described above.

In April 1999, Mr. Cain and Mr. Demirjian, respectively the company's Chief Administrative Officer and the company's General Counsel at that time, each borrowed \$425,063 from the company to exercise all 18,750 of their then-vested options at an exercise price of \$22.67 per share. The notes which evidence these borrowings are full recourse, are due on or before the third anniversary date and bear interest at a rate equal to 5.75%, payable annually. The notes were accompanied by pledge agreements which pledge the exercised option shares as collateral security for repayment of the notes, which shares are currently held by the company. In late August, Mr. Cain, Mr. Demirjian and Mr. Kingsbury (the company's Chief Financial Officer at that time) borrowed \$2.625 million, \$2.625 million and \$1.75 million, respectively, from the company, related to their purchases of 75,000, 75,000 and 50,000 shares, respectively, of the company's common stock from third parties at \$35 per share. The notes which evidence these borrowings are full recourse, are due on or before the third anniversary date and bear interest at a rate equal to 5.75%, payable annually. These notes were accompanied by pledge agreements which pledge the shares as collateral security for repayment of the notes, which shares are currently held by the company. Although the notes receivable are full recourse, are not due until the year 2002 and there has been no event of default, the company is not certain that it will be able to collect the full amount due. In March 2000, the borrowers either challenged the enforceability or declined to confirm their intention to comply with the terms of the notes and each have refused to provide the company with personal financial information that would support their ability to pay the full amounts due. The company has accrued a loss contingency at December 31, 1999 in the amount of \$5.3 million, representing the difference between the principal amount of the notes receivable and the value of the shares held by the company as collateral. The company is negotiating with the borrowers concerning deferral or compromise of their obligations under their notes.

In November 1999, the company entered into an agreement with Mr. Maher, pursuant to which, among other things, Mr. Maher agreed to provide certain consulting services to the company over a two year period, including providing information about past transactions or other matters as to which he may be familiar, and the company agreed to pay Mr. Maher twenty-four monthly payments of \$25,000. To date, the company has made one such payment to Mr. Maher, in December 1999.

Mr. Pond, one of our directors, was a principal of Donaldson, Lufkin & Jenrette Securities Corporation prior to March 2000. DLJ has provided in the past and may provide us in the future with investment banking services. DLJ served as an advisor on certain matters during 1999.

Mr. Thompson, one of our directors, is Chairman of the law firm of Winston & Strawn. Winston & Strawn has provided in the past and may provide us in the future with legal representation.

PART IV

Item 14. Exhibits, Financial Statements and Reports on Form 8-K

(a) The consolidated financial statements filed as part of this report are listed in the accompanying Index to Consolidated Financial Statements. The financial statement schedule filed as part of this report is listed below.

(b) The Registrant filed the following Current Reports on Form 8-K during the quarter ended December 31, 1999:

(1) A Form 8-K dated November 22, 1999 reporting under Item 5 of Form 8-K certain changes to the Board of Directors and management of the Registrant.

(2) A Form 8-K dated December 15, 1999 reporting under Item 5 of Form 8-K the adoption of a Stockholder Rights Plan and the addition of two directors to the Board of Directors of the Registrant.

(c) The exhibits filed as part of this report are listed below:

a. **Exhibits:**

Exhibit No. **Description**

2.1*	Plan and Agreement of Merger, dated as of February 7, 1999, by and among the Metzler Group, Inc., MGI Acquisition III, Inc., Strategic Decisions Group (SDG), and certain SDG Executives
3.1	Amended and Restated Certificate of Incorporation of the Registrant (1)
3.2	Amendment No. 1 to Amended and Restated Certificate of Incorporation of the Registrant (2)
3.3	Amendment No. 2 to Amended and Restated Certificate of Incorporation of the Registrant (3)
3.4	Amended and Restated By-Laws of the Registrant (4)
4.2	Form of Registration Agreement (6)
4.3	Rights Agreement dated as of December 15, 1999 between the Registrant and American Stock Transfer & Trust Company, as Rights Agent, (which includes the form of Certificate of Designations setting forth the terms of the Series A Junior Participating Preferred Stock as Exhibit A, the form of Rights Certificate as Exhibit B and the Summary of Rights to Purchase Preferred Stock as Exhibit C) (7)
10.1†	Form of Indemnification Agreement (5)
10.2*†	The Metzler Group, Inc. Long-Term Incentive Plan
10.3†	The Metzler Group, Inc. Employee Stock Purchase Plan (8)
10.4†	Amendment No. 1 to The Metzler Group, Inc. Employee Stock Purchase Plan (6)
10.5†	Amendment No. 2 to The Metzler Group, Inc. Employee Stock Purchase Plan (6)
10.6*†	Amendment No. 3 to The Metzler Group, Inc. Employee Stock Purchase Plan
10.7*†	Amendment No. 4 to The Metzler Group, Inc. Employee Stock Purchase Plan
10.8*†	Employment Agreement dated as of November 12, 1999 between the Registrant and Mitchell H. Saranow
10.9*†	Employment Agreement dated as of November 12, 1999 between the Registrant and John J. Reed

Exhibit No. Description

10.10*†	Employment Agreement dated as of November 12, 1999 between the Registrant and Carl S. Spetzler
10.11*†	Letter agreement dated February 1, 2000 between the Registrant and Philip P. Steptoe
10.12*†	Consulting Agreement and General Release dated as of November 21, 1999 between the Registrant and Robert P. Maher
10.13*†	Letter agreement dated February 27, 2000 between the Registrant and Barry S. Cain
21.1*	Significant Subsidiaries of the Registrant.
23.1*	Consent of KPMG LLP
23.2	Consent of Arthur Andersen LLP and Report of Independent Accountants
23.3	Consent of PricewaterhouseCoopers LLP and Report of Independent Accountants
23.4	Consent of Crowe, Chizek and Company LLP and Report of Independent Accountants
27.1*	Financial Data Schedule—for the period ended December 31, 1999

-
- (1) Incorporated by reference from the Registrant's Registration Statement on Form S-1 (Registration No. 333-9019) filed with the SEC on July 26, 1996
 - (2) Incorporated by reference from the Registrant's Registration Statement on Form S-3 (Registration No. 333-40489) filed with the SEC on November 18, 1997.
 - (3) Incorporated by reference from the Registrant's Form 8-A12B filed with the SEC on July 20, 1999.
 - (4) Incorporated by reference from the Registrant's Amendment No. 1 to Registration Statement on Form S-3 (Registration No. 333-40489) filed with the SEC on February 12, 1998
 - (5) Incorporated by reference from the Registrant's Amendment No. 2 to Registration Statement on Form S-1 (Registration No. 333-9019) filed with the SEC on September 20, 1996.
 - (6) Incorporated by reference from the Registrant's Annual Report on Form 10-K for the year ended December 31, 1998.
 - (7) Incorporated by reference from the Registrant's Current Report on Form 8-K dated December 15, 1999.
 - (8) Incorporated by reference from the Registrant's Registration Statement on Form S-8 (Registration No. 333-30265) filed with the SEC on June 27, 1997.

* Indicates filed herewith.

† Indicates a management contract or compensatory plan or arrangement required to be filed as an exhibit to this Form 10-K.

b. Financial Statement Schedule:

Report of Independent Auditors

Schedule II: Valuation and Qualifying Accounts

SIGNATURES

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

NAVIGANT CONSULTING, INC.

By: /s/ WILLIAM M. GOODYEAR
 William M. Goodyear
 Chairman and Chief Executive Officer

INDEX TO THE FINANCIAL STATEMENTS
NAVIGANT CONSULTING, INC. AND SUBSIDIARIES

Audited Consolidated Financial Statements as of December 31, 1999 and 1998, and for each of the three years in the period ended December 31, 1999.

	<u>Page</u>
Independent Auditors' Reports	F-2
Consolidated Balance Sheets	F-6
Consolidated Statements of Operations	F-7
Consolidated Statements of Stockholders' Equity	F-8
Consolidated Statements of Cash Flows	F-9
Notes to Consolidated Financial Statements	F-10

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Stockholders
Navigant Consulting, Inc.:

We have audited the accompanying consolidated balance sheets of Navigant Consulting, Inc. and subsidiaries as of December 31, 1999 and 1998 and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 1999. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the results of operations, stockholders' equity, and cash flows for the year ended December 31, 1997 related to companies acquired that were accounted for under the pooling of interests method, which statements reflect total revenues and net income constituting 69 percent and 61 percent, respectively, of the related restated consolidated totals. Those statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for companies acquired that were accounted for under the pooling of interests method, is based solely on the reports of the other auditors.

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

The 1998 and 1997 consolidated financial statements have been restated as discussed in note 3 to the consolidated financial statements.

In our opinion, based on our audits and the reports of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Navigant Consulting, Inc. and subsidiaries as of December 31, 1999 and 1998, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1999 in conformity with generally accepted accounting principles.

/s/ KPMG LLP

Chicago, Illinois
March 28, 2000

REPORT OF INDEPENDENT ACCOUNTANTS

To the Shareholders and Board of Directors of LECG, Inc.:

We have audited the statements of income, shareholders' equity and cash flows of LECG, Inc. (a California corporation) and subsidiaries for the year ended December 31, 1997, which were audited prior to the restatement (and, therefore, are not presented herein) for the pooling-of-interest as described in Note 3 to the restated financial statements included on pages F-1–F-14.

We have audited the statements of income, shareholders' equity and cash flows of LECG, Inc. (a California corporation) and subsidiaries as of December 31, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the results of their operations and their cash flows for the year ended December 31, 1997, in conformity with generally accepted accounting principles.

/s/ ARTHUR ANDERSEN & CO.

San Francisco, California
January 30, 1998

REPORT OF INDEPENDENT AUDITORS

To the Members Peterson Consulting L.L.C.

We have audited the consolidated statements of operations, members' equity, and cash flows for the year ended December 31, 1997 (not included herein) of Peterson Consulting L.L.C. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the results of operations and cash flow for the year ended December 31, 1997 of Peterson Consulting L.L.C. in conformity with generally accepted accounting principles.

CROWE, CHIZEK AND COMPANY LLP

Oak Brook, Illinois
March 17, 1998

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors
Resources Management International, Inc.
Rancho Cordova, California

We have audited the accompanying consolidated balance sheet of Resource Management International, Inc. and Subsidiaries as of December 31, 1997, and the related consolidated statements of operations, stockholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Resource Management International, Inc. and Subsidiaries at December 31, 1997, and the consolidated results of its operations and its cash flows for the year then ended, in conformity with generally accepted accounting principles.

/s/ COOPERS & LYBRAND L.L.P.

Sacramento, California
February 11, 1998

NAVIGANT CONSULTING, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands)

<u>ASSETS</u>	December 31,	
	1999	1998
Current assets:		
Cash and cash equivalents	\$ 42,345	\$119,704
Accounts receivable, net	116,100	80,163
Prepaid and other current assets	7,364	6,979
Income tax receivable	8,211	—
Deferred income taxes	2,385	—
Total current assets	176,405	206,846
Property and equipment, net	33,763	22,197
Intangible assets, net	202,096	—
Other assets	2,412	1,474
Total assets	\$414,676	\$230,517
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
Current liabilities:		
Short-term debt	\$ 10,000	\$ —
Accounts payable and accrued liabilities	20,709	17,955
Accrued compensation and project costs	58,425	28,142
Income taxes payable	—	2,942
Deferred income taxes	—	2,171
Other current liabilities	19,673	9,127
Total current liabilities	108,807	60,337
Deferred income taxes	725	5,276
Other non-current liabilities	4,475	—
Total liabilities	114,007	65,613
Stockholders' equity:		
Preferred stock, \$.001 par value; 3,000 shares authorized; no shares issued or outstanding	—	—
Common stock, \$.001 par value; 75,000 shares authorized; 43,129 and 38,004 shares issued and outstanding in 1999 and 1998, respectively	43	38
Additional paid-in capital	340,528	134,624
Treasury stock 2,086 shares at December 31, 1999	(52,811)	—
Notes receivable from stockholders	(2,583)	—
Accumulated other comprehensive income	(158)	(30)
Retained earnings	15,650	30,272
Total stockholders' equity	300,669	164,904
Total liabilities and stockholders' equity	\$414,676	\$230,517

See accompanying Notes to the Consolidated Financial Statements.

NAVIGANT CONSULTING, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)

	<u>For the Years Ended December 31,</u>		
	<u>1999</u>	<u>1998</u>	<u>1997</u>
Revenues	\$397,694	\$287,626	\$228,731
Cost of services	266,080	174,175	145,144
Gross profit	131,614	113,451	83,587
General and administrative expenses	107,274	62,093	55,579
Amortization	24,300	—	—
Merger related cost and restructuring charges (benefit)	(206)	12,778	1,312
Stock option compensation expense	3,850	—	—
Operating income (loss)	<u>(3,604)</u>	<u>38,580</u>	<u>26,696</u>
Other expense (income):			
Interest income	(3,857)	(3,063)	(1,184)
Interest expense	376	688	446
Other, net	5,672	(263)	(467)
Total other expense (income)	<u>2,191</u>	<u>(2,638)</u>	<u>(1,205)</u>
Income (loss) before income tax expense	(5,795)	41,218	27,901
Income tax expense	8,827	25,637	9,237
Net Income (loss)	<u>\$ (14,622)</u>	<u>\$ 15,581</u>	<u>\$ 18,664</u>
Earnings (loss) per share:			
Basic	\$ (0.35)	\$ 0.43	\$ 0.56
Diluted	\$ (0.35)	\$ 0.41	\$ 0.55
Weighted average shares outstanding:			
Basic	41,601	36,476	33,289
Diluted	41,601	37,707	33,798

See accompanying Notes to the Consolidated Financial Statements.

NAVIGANT CONSULTING, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands)

	Preferred Shares	Stock Amount	Common Shares	Stock Dollars	Additional Paid-In Capital	Notes Receiv- able From Share- holders	Accum. Other Compre- hensive Income	Retained Earnings	Treasury Shares	Stock Amount	Total Stock- holders' Equity
Balance at December 31, 1996	—	—	33,446	\$34	\$ 41,313	\$(3,045)	\$ 6	\$12,378	—	—	\$ 50,686
Comprehensive income	—	—	—	—	—	—	(63)	18,664	—	—	18,601
Issuance of common stock	—	—	2,043	2	25,412	(87)	—	780	—	—	26,107
Purchase of common stock	—	—	(535)	(1)	10,340	44	—	(228)	—	—	(10,525)
Distributions	—	—	—	—	—	(351)	—	(16,182)	—	—	(16,533)
Interest on notes receivable from stockholders	—	—	—	—	195	(195)	—	—	—	—	—
Collection of notes receivable from stockholders	—	—	—	—	—	879	—	—	—	—	879
Balance at December 31, 1997	—	—	34,954	35	56,580	(2,755)	(57)	15,412	—	—	69,215
Comprehensive income	—	—	—	—	—	—	27	15,581	—	—	15,608
Issuance of common stock	—	—	3,645	4	96,965	—	—	—	—	—	96,969
Purchase of common stock	—	—	(595)	(1)	(18,921)	—	—	—	—	—	(18,922)
Distributions	—	—	—	—	—	—	—	(721)	—	—	(721)
Interest on notes receivable from stockholders	—	—	—	—	—	—	—	—	—	—	—
Collection of notes receivable from stockholders	—	—	—	—	—	2,755	—	—	—	—	2,755
Balance at December 31, 1998	—	—	38,004	38	134,624	—	(30)	30,272	—	—	164,904
Comprehensive income (loss)	—	—	—	—	—	—	(128)	(14,622)	—	—	(14,750)
Issuance of common stock	—	—	5,387	5	215,160	—	—	—	—	—	215,165
Purchase of common stock	—	—	(263)	—	(13,335)	—	—	—	(2,086)	(52,811)	(66,146)
Stock option compensation expense	—	—	—	—	3,850	—	—	—	—	—	3,850
Issuance of notes receivable from stockholders	—	—	—	—	—	(20,550)	—	—	—	—	(20,550)
Interest on notes receivable from stockholders	—	—	—	—	229	(229)	—	—	—	—	—
Collection of notes receivable from stockholders	—	—	—	—	—	12,929	—	—	—	—	12,929
Impairment of notes receivable from stockholders	—	—	—	—	—	5,267	—	—	—	—	5,267
Balance at December 31, 1999	—	—	43,129	\$43	\$340,528	\$(2,583)	\$(158)	\$15,560	(2,086)	\$(52,811)	\$300,669

See accompanying Notes to the Consolidated Financial Statements.

NAVIGANT CONSULTING, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	For the Years Ended December 31,		
	1999	1998	1997
Cash flows from operating activities:			
Net income (loss)	\$(14,622)	\$ 15,581	\$18,664
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	13,460	4,876	3,337
Amortization	24,300	—	—
Impairment of stockholder notes	5,267	—	—
Stock option compensation expense	3,850	—	—
Provision for bad debts	14,900	1,094	172
Deferred income taxes	(10,970)	1,777	2,499
Other non-cash items, net	404	(107)	(728)
Changes in assets and liabilities, net of acquisitions:			
Accounts receivable	(19,543)	(20,917)	(12,339)
Prepaid expenses and other current assets	1,478	(3,467)	(1,292)
Accounts payable and accrued liabilities	(2,069)	7,291	2,099
Accrued compensation and project costs	10,591	11,029	134
Income taxes payable	(13,023)	(858)	2,923
Other current liabilities	3,426	4,907	1,353
Net cash provided by operating activities	17,449	21,206	16,822
Cash flows from investing activities:			
Purchase of property and equipment	(18,641)	(13,340)	(7,871)
Acquisition of businesses, net of cash acquired	(42,055)	—	—
Other, net	(1,582)	(296)	54
Net cash used in investing activities	(62,278)	(13,636)	(7,817)
Cash flows from financing activities:			
Issuance of common stock	17,387	96,969	26,107
Purchase of common stock	(40,011)	(18,922)	(10,525)
Repayment of long-term debt	(322)	(319)	(1,550)
Proceeds from long-term debt	—	—	3,300
Net repayments of short-term debt	(2,584)	(8,242)	(3,007)
Proceeds from short-term debt	10,000	—	—
Issuance of notes receivable from stockholders	(17,000)	—	—
Payments of pre-acquisition undistributed income to former stockholders	—	(6,079)	(10,121)
Other, net	—	2,755	(1,096)
Net cash (used in) provided by financing activities	(32,530)	66,162	3,108
Net (decrease) increase in cash and cash equivalents	(77,359)	73,732	12,113
Cash and cash equivalents at beginning of year	119,704	45,972	33,859
Cash and cash equivalents at end of year	\$ 42,345	\$119,704	\$45,972

See accompanying Notes to Consolidated Financial Statements.

NAVIGANT CONSULTING, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Description of Business

Navigant Consulting, Inc. (the “Company”) is a provider of consulting services to electric and gas utilities, insurance companies, and pharmaceutical companies, as well as other Fortune 100 companies. The Company’s services include: management consulting, strategic consulting, financial and claims services, and economics and policy consulting. The Company is headquartered in Chicago, Illinois and has regional offices in various cities within the United States, and several international offices.

2. Summary of Significant Accounting Policies

Principles of Consolidation

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

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash equivalents are comprised of highly liquid instruments with original maturities of 90 days or less. The carrying amount of these financial instruments approximates fair value because of the short maturities.

Property and Equipment

Property and equipment are recorded at cost. Depreciation is computed using the straight-line method based on the estimated useful lives, ranging from three to forty years, of the various classes of property and equipment. Amortization of leasehold improvements is computed over the shorter of the lease term or the estimated useful life of the asset.

Intangible Assets

Intangible assets consist of identifiable intangibles and goodwill. Identifiable intangibles include customer lists, workforce in place, knowledge capital, and non-compete agreements. Intangible assets, including goodwill, are being amortized on the straight-line method over 7 years.

Fair Value of Financial Instruments

The Company considers the recorded value of its financial assets and liabilities, which consist primarily of cash and cash equivalents, accounts receivable and accounts payable, to approximate the fair value of the respective assets and liabilities at December 31, 1999 and 1998.

NAVIGANT CONSULTING, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Revenue Recognition

The Company recognizes revenues as the related services are provided. Certain contracts are accounted for on the percentage of completion method whereby revenues are recognized based upon costs incurred in relation to total estimated costs at completion. Provision is made for the entire amount of estimated losses, if any, at the time when they are known.

Stock Based Compensation

The Company utilizes the intrinsic value-based method of accounting for its stock-based compensation arrangements with employees. The Company utilizes the fair value method of accounting for its stock-based compensation arrangements with non-employee consultants, advisors, and independent contractors.

Income Taxes

Income taxes are accounted for in accordance with the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Prior to December 18, 1997, one of the Company's subsidiaries, LECG, Inc. (LECG), had elected to be taxed under Subchapter S of the Internal Revenue Code for income tax purposes. During such period, federal income taxes were the responsibility of LECG's stockholders as were certain state income taxes. Therefore, the financial statements do not include a provision for federal (and some state) income taxes prior to LECG's initial public offering on December 18, 1997. LECG's S-corporation status terminated on December 18, 1997, thereby subjecting LECG's income to federal and certain other state income taxes at the corporate level. Accordingly, LECG applied the provisions of Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes," for the period ended December 31, 1997. In addition, LECG converted from a cash basis to accrual basis for tax purposes in conjunction with its conversion to a C-corporation. Due to temporary differences in recognition of revenue and expenses, income for financial reporting purposes exceeded income for income tax purposes. The conversion to accrual basis along with these temporary differences resulted in the recognition of a net deferred tax liability (and a corresponding one-time charge to expense) of \$2.7 million as of December 31, 1997.

Prior to August 14, 1998, another of the Company's subsidiaries, Peterson Consulting, L.L.C. d/b/a Peterson Worldwide LLC (Peterson) was a limited liability company, which, for income tax purposes, was treated as a partnership. Accordingly, the income of Peterson was reported on the individual income tax returns of its members and federal income taxes, as well as certain state income taxes, were the responsibility of its members. Subsequent to August 14, 1998, and based on events unrelated to its acquisition by the Company, Peterson elected C-corporation status, thereby subjecting its income to federal and certain state income taxes at the corporate level. As a result of its acquisition of Peterson, the Company has applied the provisions of SFAS No. 109, and has converted Peterson from the modified cash basis to the accrual basis for tax purposes. Due to temporary differences in recognition of revenue and expense, income for financial reporting purposes has exceeded income for tax reporting purposes. The conversion to accrual basis, along with these temporary differences, resulted in the recognition of a one-time, non-cash charge of \$7.2 million to be recorded during the period in which the merger occurred.

NAVIGANT CONSULTING, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Earnings Per Share

The following table set forth the components of basic and diluted earnings per share:

	<u>Year Ended December 31,</u>		
	<u>1999</u>	<u>1998</u>	<u>1997</u>
	(Amounts in thousands)		
Numerator:			
Net income (loss)	<u>\$(14,622)</u>	<u>\$15,581</u>	<u>\$18,664</u>
Denominator:			
Weighted average shares outstanding	41,601	36,476	33,289
Effect of dilutive securities:			
Employee stock options	<u>—</u>	<u>1,231</u>	<u>509</u>
Denominator for diluted earnings per share	<u>41,601</u>	<u>37,707</u>	<u>33,798</u>

For the year ended December 31, 1999, the weighted-average effect of employee stock options was 1.68 million shares. However, the Company incurred a loss for the period and the effect of these options was anti-dilutive.

Foreign Currency Translation

The balance sheets of the Company's foreign subsidiaries are translated into U.S. dollars using the year-end exchange rate, and sales and expenses are translated using the average exchange rate for the year. The resulting translation gains or losses are recorded as a separate component of stockholders' equity as other comprehensive income.

3. Reconciliation to Previously Reported Amounts

The following table sets forth select operating information as previously reported and as amended. The amended amounts have been restated to retroactively reflect the results of operations for certain business combinations completed in 1998 and 1997 which were accounted for as poolings of interests. At the respective dates of acquisition, the Company had determined that the stockholders' equity and the results of operations of these businesses were not material, individually or in the aggregate, in relation to those of the Company. As such, the Company had recorded these combinations by restating stockholders' equity as of the effective date of each acquisition without restating prior period financial statements. The Company has restated the financial statements for 1998 and 1997 to reflect the results of operations of Sterling Consulting Group, Inc., Reed-Stowe & Co., Inc., AUC Management Consultants, Inc., Hydrologic Consultants, Inc. of California, Saraswati Systems Corporation and Applied Health Outcomes, Inc.

NAVIGANT CONSULTING, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The amended amounts also incorporate certain reclassifications to conform the presentation of revenue and cost of sales for 1998 and 1997 to the 1999 presentation. Certain billable expenses which had previously been presented net of related revenues have been reclassified.

	Years Ended December 31,	
	1998	1997
	(amounts in thousands, except per share amounts)	
Total revenue, as previously reported	\$266,877	\$196,780
Retroactive effect of pooling accounting	6,844	19,079
Reclassifications	13,905	12,872
Total revenue, as amended	<u>\$287,626</u>	<u>\$228,731</u>
Gross profit, as previously reported	\$112,555	\$ 81,658
Retroactive effect of pooling accounting	896	1,929
Reclassifications	—	—
Gross profit, as amended	<u>\$113,451</u>	<u>\$ 83,587</u>
Operating income, as previously reported	\$ 38,884	\$ 26,195
Retroactive effect of pooling accounting	(304)	501
Operating income, as amended	<u>\$ 38,580</u>	<u>\$ 26,696</u>
Net income, as previously reported	\$ 16,123	\$ 18,419
Retroactive effect of pooling accounting	(542)	245
Net income, as amended	<u>\$ 15,581</u>	<u>\$ 18,664</u>
Earnings per diluted share as previously reported	\$ 0.43	\$ 0.57
Retroactive effect of pooling accounting	(0.02)	(0.02)
Earnings per diluted share, as amended	<u>\$ 0.41</u>	<u>\$ 0.55</u>
Dilutive shares as previously reported	37,179	32,288
Retroactive effect of pooling accounting	528	1,510
Dilutive shares, as amended	<u>37,707</u>	<u>33,798</u>

4. Business Combinations

On July 31, 1997, the Company issued 3.2 million shares of common stock for substantially all the outstanding common stock of Resource Management International, Inc. (RMI). In connection with the acquisition of RMI, the Company acquired assets and assumed liabilities with book values of \$13.9 million and \$11.1 million, respectively. On August 15, 1997, the Company issued 0.8 million shares of common stock for substantially all of the outstanding common stock of Reed Consulting Group, Inc. (Reed). In connection with the acquisition of Reed, the Company acquired assets and assumed liabilities with book values of \$2.5 million and \$2.5 million, respectively. Additionally, the Company completed the acquisition of all of the common stock of L.E. Burgess Consultants, Inc. (Burgess) as of January 1, 1997 and Sterling Consulting Group, Inc. (Sterling) and Reed-Stowe & Co., Inc. (RSC), as of December 1, 1997. In the aggregate for the Burgess, Sterling and RSC transactions, the Company issued 0.7 million shares of common stock. In connection with the acquisitions of Burgess, Sterling and RSC, the Company acquired assets and assumed liabilities with book values of \$0.6 million and \$0.9 million, respectively. All of the 1997 transactions were accounted for as poolings of interests. There

NAVIGANT CONSULTING, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

were no pre-acquisition intercompany transactions or investments among the Company, RMI, Reed, Burgess, Sterling, and RSC. The Company's consolidated financial statements have been restated as if RMI, Reed, Sterling and RSC had been combined for all periods presented. The Company's consolidated statement of operations for the year ended December 31, 1997 includes revenues and net income from RMI, Reed, Sterling and RSC totaling \$35.3 million and \$1.5 million, respectively, through the dates of acquisition. The stockholders' equity and the operations of Burgess were not significant in relation to those of the Company. As such, the Company recorded the Burgess transaction by restating stockholders' equity as of the date of the acquisition without restating prior period financial statements.

On August 19, 1998, the Company issued 7.3 million shares of common stock for substantially all the outstanding common stock of LECG. In connection with the acquisition of LECG, the Company acquired assets and assumed liabilities with book values of \$49.8 million and \$17.4 million, respectively. On August 31, 1998, the Company issued 5.6 million shares of common stock for substantially all of the outstanding common stock of Peterson. In connection with the acquisition of Peterson, the Company acquired assets and assumed liabilities with book values of \$34.8 million and \$24.7 million, respectively. Additionally, the Company completed the acquisitions all of the common stock of American Corporate Resources, Inc. (ACR), AUC Management Consultants, Inc. (AUC), and Hydrologic Consultants, Inc. of California (HCI) as of April 3, 1998; The Vision Trust Marketing Group, LLC (VTM) as of June 1, 1998; and Saraswati Systems Corporation (SSC) and Applied Health Outcomes, Inc. (AHO) as of September 1, 1998. In the aggregate for the ACR, AUC, HCI, VTM, SSC, and AHO transactions, the Company issued 1.2 million shares of common stock. In connection with the acquisitions of ACR, AUC, HCI, VTM, SSC, and AHO, the Company acquired assets and assumed liabilities with book values of \$1.9 million and \$1.4 million, respectively. All of the 1998 transactions were accounted for as poolings of interests. The Company's consolidated financial statements have been restated as if LECG, Peterson, AUC, HCI, SSC, and AHO had been combined for all periods presented. The Company's consolidated statement of operations for the year ended December 31, 1998 and 1997 includes revenues totaling \$104.8 million and \$125.7 million, respectively, and net income totaling \$5.5 million and \$9.0 million, respectively, from LECG, Peterson, AUC, HCI, SSC, and AHO, through the dates of acquisition. The stockholders' equity and the operations of ACR and VTM were not significant in relation to those of the Company. As such, the Company recorded the ACR and VTM transactions by restating stockholders' equity as of the date of the acquisition without restating prior period financial statements.

The Company incurred significant costs and expenses in connection with these acquisitions, including legal and accounting, and other various expenses. These costs and expenses were recorded in the consolidated statements of operations during the third quarter in each of the years 1998 and 1997.

During 1999, the Company completed eleven acquisitions (collectively, the "1999 Acquisitions") in exchange for Company stock and cash having an aggregate value of \$235.7 million. On February 7, 1999, the Company issued 2.4 million shares of common stock (valued at the time of closing at approximately \$123.7 million) for substantially all of the outstanding common stock of Strategic Decisions Group, Inc. and acquired the remaining minority interest in exchange for \$13.3 million in cash. On March 31, 1999, the Company completed the acquisitions of all of the outstanding stock of Triad International, Inc., GeoData Solutions, Inc., and Dowling Associates, Inc. in exchange for 1.8 million shares of the Company's common stock (valued at the time of closing at approximately \$57.3 million). On September 30, 1999, the Company completed its acquisition of the business operations and certain assets of Penta Advisory Services LLC (Penta) and the stock of Scope International, Inc. (Scope) for a total cash purchase price of \$15.1 million. The purchase agreements for Penta and Scope also provide for additional payments, payable in cash or Company common stock, over the next two to five years contingent on future revenue growth and gross margin targets. The additional payments, if any, will be accounted for as additional goodwill. On October 1, 1999, the Company completed the acquisition of the stock of Brooks International AB, Brooks International Consulting OY, and Brooks International SPRL for an

NAVIGANT CONSULTING, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

aggregate cash purchase price of \$3.3 million. On November 1, 1999, the Company completed the acquisition of the stock of The Barrington Consulting Group, Inc. (Barrington) in exchange for \$14.4 million in cash paid at closing and total deferred cash payments of \$7.8 million, payable in two equal annual installments. The liability related to the deferred cash payments is reflected in the consolidated balance sheet as of December 31, 1999 as \$3.9 million of other current liabilities and \$3.9 million of other non-current liabilities. The purchase agreement for Barrington also provides for additional cash payments of up to \$7.7 million in the aggregate, which are contingent on continued employment by the Company of certain Barrington shareholders and are payable in cash in two annual installments. The contingent payments will be charged to expense ratably over the period of employment. On December 1, 1999, the Company completed the acquisition of all of the assets of Glaze Creek Partners, LLC in exchange for \$0.8 million in cash. There were no pre-acquisition intercompany transactions between the Company and the 1999 Acquisitions.

The 1999 Acquisitions have been accounted for by the purchase method of accounting and, accordingly, the results of operations have been included in the accompanying consolidated financial statements from the date of acquisition. Certain assets acquired of \$46.2 million and liabilities assumed of \$36.9 million have been recorded at their estimated fair values. The excess of cost over the net assets acquired of approximately \$226.4 million has been recorded as intangible assets, including goodwill. The allocation of the excess cost over the net assets acquired to identifiable intangible assets and goodwill was based upon independent appraisals, as were the estimated useful lives. The estimated lives range from between one and 20 years, and approximate, on a straight-line basis, an average life of 7 years.

The following unaudited pro forma financial information presents the combined results of operations as if the 1999 Acquisitions had occurred as of January 1, 1998, after giving effect to certain adjustments. The adjustments include the amortization of goodwill and other intangibles, a reduction in interest income and related income tax effects, and an increase in the weighted average common shares outstanding. The pro forma information is for informational purposes only. The information presented does not necessarily reflect the results of operations that would have occurred had the acquisitions been completed as of January 1, 1998, nor are they indicative of future results.

	1999	1998
Revenue, in thousands	\$437,095	\$402,664
Net loss, in thousands	(23,600)	(17,995)
Net loss per diluted share	\$ (0.52)	\$ (0.44)

5. Stockholders' Equity

Initial Public Offering

On December 18, 1997, LECG completed an initial public offering, resulting in net proceeds of approximately \$24.4 million, net of issuance costs.

Secondary Public Offering

On March 2, 1998, the Company completed a secondary offering of its common stock in which an additional 1.5 million shares were sold by the Company, resulting in net proceeds of approximately \$36 million. On November 19, 1998, the Company completed a secondary offering of its common stock in which an additional 1.5 million shares were sold by the Company, resulting in net proceeds of approximately \$51 million.

NAVIGANT CONSULTING, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Employee Stock Purchase Plan

During 1996, the Company implemented a plan which permits employees to purchase shares of the Company's common stock each quarter at 85% of the market value. The market value for this purpose is determined to be the lower of the closing market price on the first and last day of each calendar quarter. There are 450,000 shares authorized for issuance under the plan. The Company had issued 159,000 shares under the plan through December 31, 1999. As of December 31, 1999, the Company held \$0.8 million of withholdings from employees which were used to purchase approximately 84,000 additional shares under the plan in January 2000.

Treasury Stock Repurchases

On August 9, 1999, the Company announced that the Board of Directors had authorized the repurchase of up to 3.0 million shares of the Company's common stock in open market or in privately negotiated transactions. In August and September of 1999, the Company repurchased a total of 0.5 million shares for \$18.9 million in privately negotiated transactions. In November 1999, the Company repurchased 1.0 million shares for \$20.8 million in open market transactions. Also in November 1999, the Company accepted 0.6 million shares with a then market value of \$12.9 million as payment for the principal amount of certain notes plus accrued interest related to borrowings by Mr. Maher, the Company's Chairman and Chief Executive Officer at that time. See also Note 17, "Related Party Transactions".

Shareholder Notes Receivable

At December 31, 1999, the Company held notes receivable from three former Company officers with an aggregate principal balance of \$7.9 million. See also Note 17, "Related Party Transactions". The notes receivable arose from transactions whereby these individuals borrowed money from the Company to purchase a total of 200,000 shares of the Company's common stock from third parties and 37,500 shares of common stock from the Company. The notes receivable are shown on the balance sheet as a reduction in stockholders' equity. The notes receivable were accompanied by pledge agreements which pledge the shares as collateral security for repayment of the notes, which shares are currently held by the Company. At the closing market price for the Company's common stock on December 31, 1999 of \$107/8 per share, the value of the shares held as collateral for the notes receivable was approximately \$2.6 million. Although the notes receivable are full recourse, are not due until the year 2002 and there has been no event of default, the Company is not certain that it will be able to collect the full amount due. In March 2000, the borrowers have either challenged the enforceability or declined to confirm their intention to comply with the terms of the notes and each have refused to provide the Company with personal financial information that would support their ability to pay the full amounts due. The Company has accrued a loss contingency at December 31, 1999 in the amount of \$5.3 million, representing the difference between the principal amount of the notes receivable and the value of the shares held by the Company as collateral. The \$5.3 million was included as a non-operating charge within other expense in the consolidated statement of operations. The Company intends to take all appropriate steps to enforce the notes in accordance with their terms.

Shareholder Rights Plan

On December 15, 1999, the Company's Board of Directors adopted a Shareholders Rights Plan (the "Rights Plan") and declared a dividend distribution of one Right (a "Right") for each outstanding share of common stock, to stockholders of record at the close of business on December 27, 1999. Each Right will entitle its holder, under certain circumstances described in the Rights Agreement, to purchase from the Company one one-thousandth of a share of its Series A Junior Participating Preferred Stock, \$.001 par value (the "Series A Preferred Stock"), at an exercise price of \$75 per Right, subject to adjustment. The description and terms of the

NAVIGANT CONSULTING, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Rights are set forth in a Rights Agreement (the “Rights Agreement”) between the Company and American Stock Transfer & Trust Company, as Rights Agent.

Until the Distribution Date under the Rights Agreement, the surrender for transfer of any shares of common stock outstanding will also constitute the transfer of the Rights associated with such shares. The Rights are not exercisable until the Distribution Date and will expire at the close of business on December 15, 2009, unless earlier redeemed or exchanged by the Company. The Company may redeem the Rights in whole, but not in part, at a price of \$.01 per Right (subject to adjustment and payable in cash, common stock or other consideration deemed appropriate by the Company’s Board of Directors) at any time until ten days following the Stock Acquisition Date under the Rights Agreement. Immediately upon the action of the Company’s Board of Directors authorizing any redemption, the Rights will terminate and the only right of the holders of Rights will be to receive the redemption price. Until a Right is exercised, its holder, as such, will have no rights as a stockholder of the Company, including, without limitation, the right to vote or to receive dividends.

6. Accounts Receivable

The components of accounts receivable as of December 31 were as follows:

	1999	1998
	(In thousands)	
Billed amounts	\$ 86,849	\$60,730
Engagements in process	45,581	27,559
Allowance for uncollectible accounts	(16,330)	(8,126)
	\$116,100	\$80,163

Engagements in process represent balances accrued by the Company for services that have been performed but have not been billed to the customer. Billings are generally done on a monthly basis for the prior month’s services.

7. Property and Equipment

Property and equipment, at cost, as of December 31 consisted of:

	1999	1998
	(In thousands)	
Land and buildings	\$ 3,421	\$ 2,878
Furniture, fixtures and equipment	40,444	27,877
Software	10,241	5,338
Leasehold improvements	5,714	4,736
	59,820	40,829
Less: accumulated depreciation and amortization	(26,057)	(18,632)
	\$ 33,763	\$ 22,197

In December 1999, the Company made a decision to dispose of its corporate headquarters land and building and is actively seeking a buyer. At such time, the Company re-evaluated the carrying amount of the asset and estimated the net realizable value through an independent appraisal. The Company has recorded additional depreciation expense of \$1.1 million to reflect the impairment in value.

Based upon a comprehensive review of the Company’s long-lived assets, the Company recorded a non-cash charge to depreciation expense of \$3.8 million in 1999. This charge reflects the write-down of a portion of the

NAVIGANT CONSULTING, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

recorded asset values of certain computer equipment and software. No additional assets were deemed to be impaired.

8. Intangible Assets

The excess of the cost of the 1999 Acquisitions over the net assets acquired of approximately \$226.4 million has been recorded as intangible assets, including goodwill, and is being amortized over the estimated useful lives. The allocation of the excess of the cost over the net assets acquired to identifiable intangible assets and goodwill was based upon independent appraisals, as were the related estimated useful lives. Goodwill and other intangible assets consisted of the following as of December 31, 1999: (in thousands)

Goodwill	\$ 96,906
Less—accumulated amortization	<u>(10,401)</u>
Goodwill, net	<u>86,505</u>
Customer lists	49,565
Employee workforce	33,455
Non-compete agreements	25,570
Other	<u>20,900</u>
Intangible assets	129,490
Less: accumulated amortization	<u>(13,899)</u>
Intangible assets, net	<u>115,591</u>
Goodwill and intangible assets, net	<u><u>\$202,096</u></u>

The Company periodically examines the carrying value of its goodwill and other intangible assets to determine whether there are any impairment losses. If indicators of impairment were present, and future cash flows were not expected to be sufficient to recover the assets' carrying amount, an impairment loss would be charged to expense in the period identified. No event has been identified that would indicate an impairment of the value of the goodwill and other intangible assets as of December 31, 1999.

9. Short-Term and Long-Term Debt

The Company maintains a line of credit agreement in the amount of \$50.0 million which expires May 31, 2001. Under the agreement, the Company may borrow a maximum amount of up to 80% of eligible accounts receivable. The agreement contains certain covenants, the most restrictive of which require the Company to maintain a minimum level of earnings before interest, taxes, depreciation and amortization. The balance outstanding under the line of credit was \$10 million at December 31, 1999. At December 31, 1999, the Company had letters of credit of \$2.2 million outstanding. The letters of credit expire at various dates through July 2003.

At December 31, 1998, the Company had no outstanding short-term debt. The Company had no long-term debt outstanding as of December 31, 1999 or 1998.

10. Merger-Related Costs and Restructuring Charges

The Company recognized \$1.2 million of expense in 1999 for employee separations associated with consolidation of certain accounting and human resources functions. In July 1999, the Company announced a restructuring initiative and offered involuntary severance packages to 73 employees in the administrative, accounting and human resources functions. In 1998, the Company incurred restructuring charges and merger-

NAVIGANT CONSULTING, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

related costs of \$12.8 million related to the acquisitions of LECG and Peterson, which were accounted for as poolings of interests. These costs included legal, accounting and other transaction related fees and expenses, as well as accruals to consolidate certain facilities. At December 31, 1999, the Company reviewed the merger-related accruals and determined that certain amounts previously accrued were no longer necessary given subsequent acquisition activity and changes in the Company's organizational structure. The results of operations for 1999 reflect a benefit of \$1.4 million for the reversal of the previously accrued amounts. In 1997, the Company incurred legal, accounting and other transaction related fees and expenses of \$1.3 million related to the acquisitions of RMI and Reed, which were accounted for as poolings of interests. During 1999, the Company increased the accrual for restructuring charges and merger-related costs by \$3.0 million related to the 1999 Acquisitions, which were accounted for under the purchase method of accounting. These costs were reflected as purchase price adjustments and, as such, increased the amount of goodwill.

The restructuring charges and merger-related costs were determined based on formal plans approved by the Company's management using the best information available at the time. The amounts the Company may ultimately incur may change as the balance of the Company's initiative to integrate acquired companies is executed. The activity affecting the accrual for restructuring charges and merger-related costs during 1999, 1998 and 1997 is as follows:

	<u>Direct Transaction Costs</u>	<u>Facilities Closings</u>	<u>Workforce Reductions</u>	<u>Other Costs</u>	<u>Total</u>
	(Amounts in thousands)				
Year ended December 31, 1997					
Charges to operations	\$ 706	\$ —	\$ 330	\$ 276	\$ 1,312
Utilized	(706)	—	(330)	(276)	(1,312)
Year ended December 31, 1998					
Charges to operations	7,638	3,600	—	1,540	12,778
Utilized	(4,434)	(239)	—	(1,655)	(6,328)
Year ended December 31, 1999					
Charges to operations	—	—	1,160	—	1,160
Purchase price adjustments	2,425	350	255	—	3,030
Utilized	(4,803)	(232)	(879)	—	(5,914)
Changes in estimates	(826)	(655)	—	115	(1,366)
Balance at December 31, 1999	<u>\$ —</u>	<u>\$2,824</u>	<u>\$ 536</u>	<u>\$ —</u>	<u>\$ 3,360</u>

11. Lease Commitments

The Company leases its office facilities and certain equipment under operating lease arrangements which expire at various dates through 2012. The Company leases office facilities under noncancelable operating leases which include fixed or minimum payments plus, in some cases, scheduled base rent increases over the term of the lease and additional rents based on the Consumer Price Index. Certain leases provide for monthly payments of real estate taxes, insurance and other operating expenses applicable to the property. In addition, the Company leases equipment under noncancelable operating leases.

NAVIGANT CONSULTING, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Future minimum annual lease payments, for the years subsequent to 1999 and in the aggregate, are as follows:

	Amount
	(In thousands)
Year Ending December 31,	
2000	\$ 15,241
2001	16,312
2002	13,965
2003	11,539
2004	8,710
Thereafter	39,439
	\$105,206

Rent expense for operating leases entered into by the Company and charged to operations amounted to \$15.8 million for 1999, \$10.0 million for 1998, and \$9.8 million for 1997.

12. Income Tax Expenses

Income tax expense consists of the following:

	December 31,		
	1999	1998	1997
	(In thousands)		
Federal:			
Current	\$14,186	\$20,180	\$5,264
Deferred	(7,391)	1,600	2,648
Total	6,795	21,780	7,912
State:			
Current	3,272	3,461	1,392
Deferred	(1,716)	396	(67)
Total	1,556	3,857	1,325
Foreign	476	—	—
Total federal, state and foreign income tax expense	\$ 8,827	\$25,637	\$9,237

NAVIGANT CONSULTING, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Income tax expense differs from the amounts estimated by applying the statutory income tax rates to income before income tax expense as follows:

	December 31,		
	1999	1998	1997
Federal tax at statutory rate	35.0%	35.0%	35.0%
State tax at statutory rate, net of federal tax benefits	(17.8)	7.3	4.6
Foreign taxes	(8.2)	—	—
Effect of nontaxable interest and dividends	12.5	(1.7)	(0.9)
Effect of nontaxable entity status	—	—	(5.2)
Effect of non-deductible merger-related costs	(1.0)	4.0	—
Effect of non-deductible amortization	(139.2)	—	—
Effect of non-deductible stock compensation expense	(23.3)	—	—
Effect of conversion from cash to accrual method of accounting for acquired company	—	14.7	—
Effect of other non-deductible expenses	(10.4)	2.9	(0.4)
	(152.4)%	62.2%	33.1%

The tax benefits associated with nonqualified stock options and disqualifying dispositions of incentive stock options reduced taxes payable by \$4.9 million in 1999 and \$3.3 million in 1998. Such benefits were recorded as an increase to additional paid-in capital in each year.

Deferred income taxes result from temporary differences between years in the recognition of certain expense items for income tax and financial reporting purposes. The source and income tax effect of these differences are as follows:

	December 31,	
	1999	1998
	(In thousands)	
Deferred tax assets:		
State income taxes	\$ (121)	\$ 479
Allowance for uncollectible receivables	4,379	194
Merger-related costs	—	1,427
Stockholders' notes	2,239	—
Insurance related costs	865	—
Other	202	315
Total deferred tax assets	7,564	2,415
Deferred tax liabilities:		
Adjustment resulting from changes in the method of accounting used for tax purposes	6,435	9,136
Other	(531)	726
Deferred tax liabilities	5,904	9,862
Net deferred tax assets (liabilities)	\$1,660	\$(7,447)

The Company has not recorded a valuation allowance as it believes it is more likely than not that the net deferred tax asset is recoverable.

NAVIGANT CONSULTING, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

13. Supplemental Cash Flow Information

Total interest paid during the years ended December 31, 1999, 1998 and 1997 were \$0.4 million, \$0.7 million, and \$0.3 million, respectively. Total income taxes paid during the years ended December 31, 1999, 1998 and 1997 were \$27.6 million, \$17.7 million, and \$3.5 million, respectively.

During the first quarter of 1999, the Company issued 4.2 million shares of common stock (valued at the time at approximately \$181.0 million) for substantially all of the outstanding common stock of four companies acquired in transactions accounted for by the purchase method of accounting. In addition to the \$42.1 million of cash used to acquire certain businesses during 1999, the Company entered into commitments for deferred cash payments of \$7.8 million, payable in two equal annual installments. See also Note 4, "Business Combinations."

In April 1999, certain of the Company's then officers borrowed \$3.5 million from the Company to exercise certain then-vested options. In November 1999, the Company received 605,684 shares of the Company's common stock, with a then market value of \$12.9 million, in lieu of cash as payment for the principal amount of certain loans plus accrued interest. See also Note 17, "Related Party Transactions."

14. Long-Term Incentive Plan

On June 30, 1996, the Company adopted a Long-Term Incentive Plan which provides for common stock, common stock-based, and other performance incentives to employees, consultants, directors, advisors, and independent contractors of the Company. The Long-Term Incentive Plan, as amended, was re-approved by a vote of the Company's shareholders in July 1999. As of December 31, 1999, the Company had 8.2 million options outstanding at a weighted average exercise price of \$29.15 per share. As of December 31, 1999, 0.7 million options were exercisable.

In general, options issued under the Long Term Incentive Plan were issued at the fair market value at the dates of grant, have a ten-year term and become vested and thus exercisable in annual installments over a four year period following the date of grant. However, the plan permits the Compensation Committee, or the chief executive officer as its delegate, to vary such terms and conditions, including granting nonqualified options at prices below fair market value at the date of grant. The Company has determined, based in part on the absence of contemporaneous documentation, that 0.3 million nonqualified options issued to a total of sixteen individuals were issued at prices below fair market value. Accordingly, the Company has recorded an expense in 1999 of \$3.5 million for stock option compensation expense attributable to such options. The amount charged to expense represents the aggregate dollar amount by which the grant prices of the options differ from the market prices as of the dates for which the Company has independent evidence to support the issuance of the options. The amount charged to expense has been amortized over the relevant vesting periods. See also Note 17, "Related Party Transactions."

The Company applies APB Opinion 25, Accounting for Stock Issued to employees, and related Interpretations in accounting for its plan. Accordingly, no compensation cost has been recognized for those option grants where the exercise price is equal to the fair market value at the date of grant. Had compensation cost for the plan been determined based on the fair value at the grant dates for awards under the plan consistent with the method of SFAS No. 123, "Accounting for Stock-Based Compensation," the Company's compensation expense for the years ended December 31, 1999, 1998 and 1997 would have been increased by \$18.3 million, \$4.6 million, and \$1.1 million, respectively, net of related income taxes. As a result, the Company's pro forma

NAVIGANT CONSULTING, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

net earnings available to common stockholders and earnings per common and common equivalent shares would have been reduced to the pro forma amounts indicated below:

	1999	1998	1997
	(In thousands, except per share amounts)		
Earnings, as reported:			
Net income (loss)	\$(14,622)	\$15,581	\$18,664
Net income (loss) per basic share	\$ (0.35)	\$ 0.43	\$ 0.56
Net income (loss) per dilutive share	\$ (0.35)	\$ 0.41	\$ 0.55
Earnings, fair value method:			
Net income (loss), with compensation expense from fair value options	\$(32,941)	\$10,990	\$17,526
Fair value method net income (loss) per basic share	\$ (0.79)	\$ 0.30	\$ 0.53
Fair value method net income (loss) per dilutive share	\$ (0.79)	\$ 0.29	\$ 0.52

The weighted average fair value of options granted in 1999, 1998 and 1997 was \$12.04, \$5.68, and \$4.46, respectively. For purposes of calculating compensation cost under SFAS No. 123, the fair value of each option grant is estimated as of the date of grant using the Black-Scholes option pricing model. The following weighted average assumptions were used in the model for grants made in 1999, 1998 and 1997:

	1999	1998	1997
Expected volatility	75%	45%	45%
Risk free interest rate	5.5%	5.0%	5.7%
Dividend yield	0%	0%	0%
Contractual or Expected lives (years)	8.5	2.8	2.5

Additional information on the shares subject to options is as follows:

	1999		1998		1997	
	Number of Shares (000's)	Weighted Average Exercise Price	Number of Shares (000's)	Weighted Average Exercise Price	Number of Shares (000's)	Weighted Average Exercise Price
Options outstanding at beginning of year	5,510	\$24.19	2,623	\$16.53	689	\$10.37
Granted	4,481	32.68	3,849	28.47	2,173	18.35
Exercised	(696)	17.98	(361)	13.07	(3)	8.00
Forfeited	(1,082)	25.24	(601)	24.90	(236)	16.35
Options outstanding at end of year	<u>8,213</u>	<u>\$29.15</u>	<u>5,510</u>	<u>\$24.19</u>	<u>2,623</u>	<u>\$16.53</u>
Options exercisable at year end	<u>676</u>	<u>\$19.31</u>	<u>138</u>	<u>\$14.41</u>	<u>14</u>	<u>\$18.45</u>

NAVIGANT CONSULTING, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table summarizes information about stock options outstanding at December 31, 1999 and 1998:

Range of Exercise Price	1999			1998		
	Weighted-Average			Weighted-Average		
	Shares Exercise Remaining			Shares Exercise Remaining		
	(000's)	Price	Life	(000's)	Price	Life
\$ 0 to \$15	790	\$12.17	4.6 years	1,025	\$12.46	0.7 years
\$16 to \$25	737	21.23	6.0 years	1,277	20.99	2.5 years
\$26 to \$35	5,656	29.03	8.8 years	3,174	29.06	3.6 years
\$36 to \$45	307	43.71	9.5 years	34	39.30	3.8 years
\$46 to \$55	723	50.53	9.1 years	—	—	—
	<u>8,213</u>	<u>\$29.15</u>	<u>8.2 years</u>	<u>5,510</u>	<u>\$24.19</u>	<u>2.8 years</u>

15. Employee Benefit Plans

The Company maintained profit sharing and savings plans for several operating subsidiaries through December 31, 1999. Eligible employees may contribute a portion of their compensation to their respective operating subsidiary's plan. The Company matches a percentage of employees' current contributions on some operating subsidiaries' plans and has discretion to match contributions on other plans. The Company may also make an annual profit sharing contribution at its discretion. The Company, as sponsor of the plans, uses independent third parties to provide administrative services to the plans. The Company has the right to terminate the plans at any time. The Company contributions to the various plans which were charged to operations were \$1.9 million, \$1.0 million, and \$1.0 million in the years ended December 31, 1999, 1998, and 1997, respectively.

Effective February 2000, the Company amended the profit sharing and savings plans of all operating subsidiaries to provide an employer matching contribution for all participants in an amount equal to 100% of the employees' current contributions, up to a maximum of 3% of the employees' total eligible compensation.

16. Segment Information

The Company has applied the provisions of SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information. This statement establishes standards for reporting information regarding operating segments, products and services, geographic areas and major customers. The Company's operations represent a single reportable segment under the provisions of SFAS No. 131. The Company's operations have a high degree of similarity in their economic and operational characteristics, including the nature of the services provided, the type or class of customers for those services, and the methods used for delivering such services. While the Company has retained certain brand identities associated with its principal operating subsidiaries, these distinctions have not been a critical factor for management in making operating decisions or in assessing performance. In addition, the structure of the Company's internal organization has changed from time to time as a result of acquisition activity and in response to customer, project, personnel or geographic requirements and, as such, discrete financial information is not available on a consistent basis at the operating subsidiary level.

The Company derives substantially all of its revenues from operations in the United States. In each of the three years ended December 31, 1999, more than 95% of the Company's consolidated revenues and operating income were derived from domestic operations. Substantially all of the Company's identifiable assets are located in the United States.

NAVIGANT CONSULTING, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

17. Related Party Transactions

In April 1999, Mr. Maher, the Company's Chairman and Chief Executive Officer at that time, borrowed \$2.7 million from the Company so that he could exercise his then-vested options. Mr. Maher exercised all 112,500 of his then-vested options at an exercise price of \$24.00 per share. In August 1999, Mr. Maher borrowed an additional \$10 million from the Company. The applicable interest rate for this loan was 5.75%, payable annually. In November 1999, the Company received from Mr. Maher 605,684 shares of the Company's common stock with a then market value of \$12.9 million as payment for the principal amount of the loans plus accrued interest.

Five non-employees related by blood or marriage to Mr. Maher received stock option grants. Mr. Maher has informed the Company that each of these persons provided services to the Company from time to time and received no other compensation for those services. In addition, one other individual not employed by the Company, but who was an employee of an unrelated company owned or controlled by Mr. Maher, received stock option grants. Mr. Maher has informed the Company that this individual provided certain services to the Company from time to time. These persons are among sixteen as to whom the Company has determined that their options were issued at prices below fair market value. See also Note 14, "Long Term Incentive Plan". The Company has recorded an expense in 1999 of \$3.5 million for stock option compensation expense attributable to such options issued to the sixteen individuals. Of the total stock option compensation expense of \$3.5 million, \$0.6 million is attributable to the six persons described above.

In April 1999, Mr. Cain and Mr. Demirjian, respectively the Company's Chief Administrative Officer and the Company's General Counsel at that time, each borrowed \$425,063 from the Company to exercise all 18,750 of their then-vested options at an exercise price of \$22.67 per share. The notes which evidence these borrowings are full recourse, are due on or before the third anniversary date and bear interest at a rate equal to 5.75%, payable annually. The notes were accompanied by pledge agreements which pledge the exercised option shares as collateral security for repayment of the notes, which shares are currently held by the Company.

In late August, Mr. Cain, Mr. Demirjian and Mr. Kingsbury (the Company's Chief Financial Officer at that time) borrowed \$2.625 million, \$2.625 million and \$1.75 million, respectively, from the Company, related to their purchases of 75,000, 75,000 and 50,000 shares, respectively, of the Company's common stock from third parties at \$35 per share. The notes which evidence these borrowings are full recourse, are due on or before the third anniversary date and bear interest at a rate equal to 5.75%, payable annually. These notes were accompanied by pledge agreements which pledge the shares as collateral security for repayment of the notes, which shares are currently held by the Company.

As a result of recent developments, the Company has accrued a loss contingency at December 31, 1999 in the amount of \$5.3 million, related to the notes receivable from Messrs. Cain, Demirjian and Kingsbury. See also Note 5, "Stockholders Equity". The Company has discontinued the accrual of interest on these notes.

In November 1999, the Company entered into an agreement with Mr. Maher, pursuant to which, among other things, Mr. Maher agreed to provide certain consulting services to the Company over a two year period, including providing information about past transactions or other matters as to which he may be familiar, and the Company agreed to pay Mr. Maher twenty-four monthly payments of \$25,000.

18. Litigation

Numerous purported class action lawsuits have been filed against the Company since November 1999 in the United States District Court for the Northern District of Illinois. These actions name as defendants the

NAVIGANT CONSULTING, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Company and certain former directors and former executive officers (one of whom, however, remains an employee of the Company) of the Company and are purported to be on behalf of persons who purchased shares of the Company's common stock during various periods through November 1999. The complaints allege various violations of federal securities law, including violations of Section 10(b) of the Securities Exchange Act of 1934, and that the defendants made materially misleading statements and/or material omissions which artificially inflated prices for the Company's common stock. The plaintiffs seek a judgement awarding damages and other relief. The Company believes it has meritorious defenses and intends to vigorously defend these actions. The outcome of these lawsuits cannot be predicted with certainty and a material adverse judgment against the Company could have a material adverse effect on the Company.

Navigant International, Inc., a national travel agency headquartered in Denver, Colorado, sued the Company in July 1999 in the United States District Court for the District of Colorado claiming that the use of "Navigant" in our name infringes on their use of and rights in such name. The complaint seeks declaratory relief and an injunction against our use of "Navigant," attorneys' fees and other related relief. The Company believes it has meritorious defenses and intends to vigorously defend this action.

In addition, from time to time, we are party to various other lawsuits and claims in the ordinary course of business. While the outcome of those lawsuits or claims cannot be predicted with certainty, we do not believe that any of those lawsuits or claims will have a material adverse effect on the Company.

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Stockholders
Navigant Consulting, Inc.:

Under date of March 28, 2000 we reported on the consolidated balance sheets of Navigant Consulting, Inc. and subsidiaries as of December 31, 1999 and 1998, and the related consolidated statements of earnings, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 1999, which report was based in part on reliance of other auditors, as contained in the annual report on Form 10-K for the year 1999. The 1998 and 1997 financial statements have been restated as discussed in notes 3 and 4 to the consolidated financial statements. In connection with our audits of the aforementioned consolidated financial statements, we also audited the related consolidated financial statement schedule of valuation and qualifying accounts. The consolidated financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion on the consolidated financial statement schedule based on our audits.

In our opinion, the consolidated financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ KPMG LLP

Chicago, Illinois
March 28, 2000

SCHEDULE II

NAVIGANT CONSULTING, INC.
VALUATION AND QUALIFYING ACCOUNTS
Years Ended December 31, 1999, 1998 and 1997
 (Amounts in thousands)

	<u>Balance at Beginning of Year</u>	<u>Charged to Expenses</u>	<u>Deductions (1)</u>	<u>Balance at End of Year</u>
Year Ended December 31, 1999	8,126	14,900	(6,696)	16,330
Allowance for doubtful accounts Year Ended December 31, 1998 . . .	7,592	2,058	(1,524)	8,126
Allowance for doubtful accounts Year Ended December 31, 1997 . . .	10,569	1,975	(4,952)	7,592
Allowance for doubtful accounts				

(1) Represent write-offs of bad debt

CONSENT OF KPMG LLP

The Board of Directors Navigant Consulting, Inc.

We consent to incorporation by reference in the registration statement (No. 333-30267) on Form S-8 of Navigant Consulting, Inc. of our reports dated March 20, 2000, relating to the consolidated balance sheets of Navigant Consulting, Inc. and subsidiaries as of December 31, 1999 and 1998, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 1999, and the related schedule, which reports appear in the December 31, 1999 annual report on Form 10-K of Navigant Consulting, Inc.

/s/ KPMG LLP

Chicago, Illinois
March 28, 2000

**ARTHUR ANDERSEN
CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS**

As independent public accountants, we hereby consent to the incorporation of our report included in this Form 10-K into the Company's previously filed Form S-8 Registration Statement No. 333-30267.

/s/ ARTHUR ANDERSEN LLP

San Francisco, California
March 23, 2000

CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

We consent to incorporation by reference in the registration statement No. 333-30267 on Form S-8 of Navigant Consulting, Inc. of our report dated March 17, 1998 relating to the consolidated statements of operations, members' equity, and cash flows for the year ended December 31, 1997 of Peterson Consulting L.L.C. which report appears in the December 31, 1999 annual report on Form 10-K of Navigant Consulting, Inc.

/s/ CROWE, CHIZEK AND COMPANY LLP

Oak Brook, Illinois
March 27, 2000

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statement on Form S-8 (No. 333-30267) of Navigant Consulting, Inc. of our report dated February 11, 1998, relating to the consolidated financial statements of Resource Management International, Inc. and Subsidiaries as of December 31, 1997, which appears in this December 31, 1999 Form 10-K.

/s/ PRICEWATERHOUSECOOPERS LLP

Sacramento, California
March 28, 2000