WATSON WYATT & CO HOLDINGS
Form 10-Q
May 07, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

ý	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the quarterly period ended March 31, 2004
	OR
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the transition period from to

Commission File Number: 001-16159

WATSON WYATT & COMPANY HOLDINGS
(Exact name of Registrant as specified in its charter)

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

1717 H Street NW
Washington, D.C. 20006-3900
(Address of principal executive offices, including zip code)

(202) 715-7000
(Registrant s telephone number, including area code)

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

Yes ý No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2).

Yes ý No o

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of April 30, 2004.

Class	**Number of Shares**
Class A Common Stock, $.01 par value	32,201,966

WATSON WYATT & COMPANY HOLDINGS
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For the Three and Nine Months Ended March 31, 2004

Certifications

WATSON WYATT & COMPANY HOLDINGS

Consolidated Statements of Operations

(Thousands of U.S. Dollars, Except Per Share Data)

	Three months ended March 31		Nine months ended March 31	
	2004	2003	2004	2003
	(Unaudited)		(Unaudited)	
Revenue	$ 180,655	$ 177,596	$ 521,991	$ 531,178
Costs of providing services:				
Salaries and employee benefits	100,231	100,584	299,678	299,935
Professional and subcontracted services	11,618	11,564	33,317	35,424
Occupancy, communications and other	28,422	27,295	77,861	79,408
General and administrative expenses	15,269	13,690	45,860	42,895
Depreciation and amortization	4,091	4,854	14,138	15,199
	159,631	157,987	470,854	472,861
Income from operations	21,024	19,609	51,137	58,317
Income from affiliates	2,261	1,322	5,099	4,229
Interest income, net	20	150	404	617
Other non-operating income	45		6,197	641
Income from continuing operations before income taxes	23,350	21,081	62,837	63,804
Provision for income taxes	9,374	8,640	25,562	26,156
Income from continuing operations	13,976	12,441	37,275	37,648
Discontinued operations:				
Adjustment to reduce estimated loss on disposal of discontinued operations [see Note 15] [less applicable income tax expense for the three and nine months ended March 31, 2004 and 2003]	592	6,752	592	6,752
Sublease income from discontinued operations, less applicable income tax expense for the three and nine months ended March 31, 2004	21		47	
Net income	$ 14,589	$ 19,193	$ 37,914	$ 44,400
Basic earnings per share:				
Income from continuing operations	$ 0.42	$ 0.37	$ 1.13	$ 1.14

Income from discontinued operations	0.02	0.21	0.02	0.21
Net income	$ 0.44	$ 0.58	$ 1.15	$ 1.35
Diluted earnings per share:				
Income from continuing operations	$ 0.42	$ 0.37	$ 1.12	$ 1.13
Income from discontinued operations	0.02	0.21	0.02	0.21
Net income	$ 0.44	$ 0.58	$ 1.14	$ 1.34
Weighted average shares of common stock, basic (000)	32,968	32,942	33,064	32,944
Weighted average shares of common stock, diluted (000)	33,288	33,242	33,401	33,277

See accompanying notes to the consolidated financial statements

WATSON WYATT & COMPANY HOLDINGS

Consolidated Balance Sheets

(Thousands of U.S. Dollars, Except Share and Per Share Data)

	March 31, 2004 (Unaudited)	June 30, 2003
Assets		
Cash and cash equivalents	$ 153,709	$ 144,374
Receivables from clients:		
Billed, net of allowances of $2,510 and $862	75,059	78,373
Unbilled, net of allowances of $867 and $419	72,042	60,549
	147,101	138,922
Deferred income taxes	7,385	3,885
Other current assets	13,763	11,448
Total current assets	321,958	298,629
Investment in affiliates	29,596	26,431
Fixed assets, net	58,730	60,716
Deferred income taxes	99,822	101,214
Goodwill and intangible assets	20,965	20,878
Other assets	5,368	6,594
Total Assets	$ 536,439	$ 514,462
Liabilities		
Accounts payable and accrued liabilities, including discretionary compensation	$ 93,625	$ 114,013
Income taxes payable	11,239	15,308
Total current liabilities	104,864	129,321
Accrued retirement benefits	200,794	195,705
Deferred rent and accrued lease losses	6,654	4,608
Other noncurrent liabilities	30,347	33,091
Total Liabilities	342,659	362,725
Commitments and contingencies		
Stockholders Equity		
Preferred Stock - No par value:		
1,000,000 shares authorized; none issued and outstanding		
Class A Common Stock - $.01 par value:		
	334	331

69,000,000 shares authorized; 33,372,880 and 33,087,880 issued and 33,011,332 and 32,943,156 outstanding				
Additional paid-in capital		150,866		145,922
Treasury stock, at cost - 361,548 and 144,724 shares		(8,555)		(2,956)
Retained earnings		115,431		77,517
Accumulated other comprehensive loss		(64,296)		(69,077)
Total Stockholders Equity		193,780		151,737
Total Liabilities and Stockholders Equity	$	536,439	$	514,462

See accompanying notes to the consolidated financial statements

WATSON WYATT & COMPANY HOLDINGS

Consolidated Statements of Cash Flows

(Thousands of U.S. Dollars)

	Nine months ended March 31	
	2004	**2003**
	(Unaudited)	
Cash flows from operating activities:		
Net income	$ 37,914	$ 44,400
Adjustments to reconcile net income to net cash from operating activities:		
Other non-operating gain related to PCIC	(5,600)	
Income from discontinued operations, net of income tax expense	(592)	(6,752)
Provision for doubtful receivables from clients	5,610	6,494
Depreciation	13,895	14,983
Amortization of intangible assets	243	216
Provision for deferred income taxes	(2,108)	(2,953)
Income from affiliates	(5,099)	(4,229)
Distributions from affiliates	4,404	3,400
Other, net	10	(843)
Changes in operating assets and liabilities (net of discontinued operations)		
Receivables from clients	(13,789)	(2,317)
Other current assets	(2,315)	6,007
Other assets	1,226	1,922
Accounts payable and accrued liabilities	(10,080)	(27,438)
Income taxes payable	(4,477)	3,000
Accrued retirement benefits	5,089	5,379
Deferred rent and accrued lease losses	2,046	973
Other noncurrent liabilities	(1,694)	1,221
Net cash from operating activities	24,683	43,463
Cash flows used in investing activities:		
Purchases of fixed assets	(12,334)	(13,402)
Proceeds from divestitures	598	1,042
Acquisitions and contingent consideration payments	(114)	(442)
Investment in affiliates		(1,961)
Net cash used in investing activities	(11,850)	(14,763)
Cash flows used in financing activities:		
Issuances of common stock - exercises of stock options	1,632	458
Issuances of common stock - employee stock purchase plan	5,024	4,768
Repurchases of common stock	(12,161)	(11,385)
Net cash used in financing activities	(5,505)	(6,159)
Effect of exchange rates on cash	2,007	1,280

Increase in cash and cash equivalents		9,335		23,821
Cash and cash equivalents at beginning of period		144,374		95,974
Cash and cash equivalents at end of period	$	153,709	$	119,795

See accompanying notes to the consolidated financial statements

WATSON WYATT & COMPANY HOLDINGS

Consolidated Statement of Changes in Stockholders Equity

(Thousands of U.S. Dollars)

(Unaudited)

	Class A Common Stock Outstanding (number of shares)	Class A Common Stock	Additional Paid-in Capital	Treasury Stock, at Cost	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance at June 30, 2003	32,943	$ 331	$ 145,922	$ (2,956)	$ 77,517	$ (69,077)	$ 151,737
Comprehensive income:							
Net income					37,914		37,914
Additional minimum pension liability						(624)	(624)
Foreign currency translation adjustment						5,405	5,405
Total comprehensive income							42,695
Repurchases of common stock	(511)			(12,161)			(12,161)
Issuances of common stock - employee stock purchase plan shares	268	1	908	4,115			5,024
Issuances of common stock - deferred stock units	178	2	4,081				4,083
Issuances of common stock to outside directors	6		10	135			145
Issuances of common stock- stock options	127		(680)	2,312			1,632
Tax benefit of exercises of stock options			625				625
Balance at March 31, 2004	33,011	$ 334	$ 150,866	$ (8,555)	$ 115,431	$ (64,296)	$ 193,780

See accompanying notes to the consolidated financial statements

WATSON WYATT & COMPANY HOLDINGS

Notes to the Consolidated Financial Statements
(Tabular amounts are in thousands, except per share data)

(Unaudited)

Note 1 Basis of Presentation

The accompanying unaudited quarterly consolidated financial statements of Watson Wyatt & Company Holdings and our subsidiaries (collectively referred to as we, Watson Wyatt or the Company) are presented in accordance with the rules and regulations of the Securities and Exchange Commission (SEC) for quarterly reports on Form 10-Q. In the opinion of management, these financial statements reflect all adjustments which are necessary for a fair presentation of the consolidated financial statements for the interim periods. The consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto contained in the Company s Annual Report on Form 10-K for the fiscal year ended June 30, 2003, which is filed with the SEC and may be accessed via EDGAR on the SEC s web site at www.sec.gov.

The results of operations for the nine months ended March 31, 2004 are not necessarily indicative of the results that can be expected for the entire fiscal year ending June 30, 2004. The results reflect certain estimates, including estimated bonuses and anticipated tax liabilities.

Note 2 Company Background

Watson Wyatt is an international company engaged in the business of providing professional consultative services on a fee basis, primarily in the human resource areas of employee benefits and compensation, but also in other areas of specialization such as human capital consulting and human resource-related technology consulting.

Note 3 Segment Information

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

(1) Benefits Group
(2) Technology Solutions Group
(3) Human Capital Group
(4) International

(5) Other (including Data Services and Communication)

The Company evaluates the performance of its segments and allocates resources to them based on net operating income, which is income before income taxes and discretionary compensation.

The table below presents specified information about reported segments as of and for the three months ended March 31, 2004:

	Benefits Group	Technology Solutions Group	Human Capital Group	International	Other	Total
Revenue (net of reimbursable expenses)	$ 110,029	$ 20,258	$ 11,639	$ 22,088	$ 9,562	$ 173,576
Net operating income/(loss)	26,541	2,729	2,085	1,713	(319)	32,749
Receivables	98,713	8,830	9,569	19,148	5,321	141,581

The table below presents specified information about reported segments as of and for the three months ended March 31, 2003:

	Benefits Group	Technology Solutions Group	Human Capital Group	International	Other	Total
Revenue (net of reimbursable expenses)	$ 103,996	$ 22,467	$ 12,216	$ 19,103	$ 10,648	$ 168,430
Net operating income/(loss)	26,741	3,081	1,549	847	(586)	31,632
Receivables	90,590	16,071	9,505	15,720	6,585	138,471

The table below presents specified information about reported segments as of and for the nine months ended March 31, 2004:

	Benefits Group	Technology Solutions Group	Human Capital Group	International	Other	Total
Revenue (net of reimbursable expenses)	$ 312,325	$ 62,398	$ 33,427	$ 60,420	$ 32,197	$ 500,767
Net operating income/(loss)	65,304	8,184	3,973	466	315	78,242
Receivables	98,713	8,830	9,569	19,148	5,321	141,581

The table below presents specified information about reported segments as of and for the nine months ended March 31, 2003:

	Benefits Group	Technology Solutions Group	Human Capital Group	International	Other	Total
Revenue (net of reimbursable expenses)	$ 301,072	$ 75,296	$ 35,402	$ 56,167	$ 36,559	$ 504,496
Net operating income/(loss)	70,684	12,731	1,076	2,171	1,549	88,211
Receivables	90,590	16,071	9,505	15,720	6,585	138,471

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

The following table includes reconciliations of the information reported by segment to the consolidated amounts for the three and nine month periods ended March 31, 2004 and 2003:

	Three Months Ended March 31		Nine Months Ended March 31	
	2004	**2003**	**2004**	**2003**
Revenue:				
Total segment revenue	$ 173,576	$ 168,430	$ 500,767	$ 504,496
Reimbursable expenses not included in total segment revenue	6,600	8,528	21,448	25,846
Other, net	479	638	(224)	836
Consolidated revenue	$ 180,655	$ 177,596	$ 521,991	$ 531,178
Net Operating Income:				
Total segment net operating income	$ 32,749	$ 31,632	$ 78,242	$ 88,211
Income from affiliates	2,261	1,322	5,099	4,229
Differences in allocation methods for depreciation, G&A, medical and pension costs	1,551	198	4,911	(897)
Gain on sale of business units	45	27	598	1,069
Discretionary compensation	(9,700)	(8,147)	(29,170)	(27,721)
PCIC non-operating gain			5,600	
Other, net	(3,556)	(3,951)	(2,443)	(1,087)
Consolidated income before income taxes	$ 23,350	$ 21,081	$ 62,837	$ 63,804
Receivables:				
Total segment receivables - billed and unbilled	$ 141,581	$ 138,471	$ 141,581	$ 138,471
Net valuation differences	5,520	8,964	5,520	8,964
Total billed and unbilled receivables	147,101	147,435	147,101	147,435
Assets not reported by segment	389,338	306,049	389,338	306,049
Consolidated assets	$ 536,439	$ 453,484	$ 536,439	$ 453,484

Note 4 Stock-based Compensation

We have elected to follow Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25), for stock options issued under the 2000 Long-term Incentive Plan and the 2001 Employee Stock Purchase Plan. Compensation expense for the 2000 Long-term Incentive Plan, if any, would be recorded and measured as the difference between the fair market value of the stock at the date of the grant and the option price. The compensation expense would be recognized over the five-year vesting period identified in the plan. For any cash-based, non-stock awards, such as stock appreciation rights, compensation expense is recognized over the vesting period to the extent that the market price of the stock increases. We have elected the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-based Compensation (FAS 123).

As required by FAS 123, the Company has determined pro forma net income and earnings per share as if the Company had accounted for its stock compensation plans under the fair value method of FAS 123. The Company estimated compensation expense for its 2001 Employee Stock Purchase Plan based on the 15 percent discounted purchase price offered to employees enrolled in the plan, which approximates fair value. For the 2000 Long-term Incentive Plan, the Company uses the Black-Scholes option valuation model to calculate the fair value of options granted for pro forma disclosure purposes.

The table below reflects the pro forma effect on net income and earnings per share for the three and nine months ended March 31, 2004 and 2003 as if the Company recognized compensation expense under the fair value method of FAS 123:

	Three Months Ended March 31		Nine Months Ended March 31	
	2004	2003	2004	2003
Net income, as reported	$ 14,589	$ 19,193	$ 37,914	$ 44,400
Add: Stock-based compensation expense included in reported net income, net of related tax effects	36	23	113	35
Deduct: Total stock-based employee compensation expense determined under fair-value-based method for all awards, net of related tax effects	(361)	(384)	(1,159)	(1,184)
Pro forma net income	$ 14,264	$ 18,832	$ 36,868	$ 43,251
Earnings per share:				
Basic - as reported	$ 0.44	$ 0.58	$ 1.15	$ 1.35
Basic - pro forma	$ 0.43	$ 0.57	$ 1.12	$ 1.31
Diluted - as reported	$ 0.44	$ 0.58	$ 1.14	$ 1.34
Diluted - pro forma	$ 0.43	$ 0.57	$ 1.10	$ 1.30

Note 5 Retirement Benefits

Defined Benefit Plans

We sponsor both qualified and non-qualified, non-contributory defined benefit pension plans covering substantially all of our associates. Under our principal plans (United States, Canada, Hong Kong and U.K.), benefits are based on the number of years of service and the associates compensation during the three highest paid consecutive years of service. The non-qualified plan provides for pension benefits that would be covered under the qualified plan but are limited by the Internal Revenue Code. The non-qualified plan has no assets and therefore is an unfunded arrangement which benefit liability is reflected on the balance sheet. Included in the results is our U.K. plan, which is inactive but is part of the additional minimum pension liability reported on the Consolidated Balance Sheets. The measurement date for the plans is June 30.

Components of Net Periodic Benefit Cost for Defined Benefit Pension Plans

The following table sets forth the components of net periodic benefit cost for the Company s U.S. and non-U.S. defined benefit pension plans for the three and nine months ended March 31, 2004 and 2003:

	Three Months Ended March 31		Nine Months Ended March 31	
	2004	**2003**	**2004**	**2003**
Service Cost	$ 6,682	$ 6,550	$ 20,046	$ 19,651
Interest Cost	8,398	8,391	25,193	25,173
Expected return on plan assets	(8,958)	(9,367)	(26,875)	(28,100)
Amortization of transition obligation	(1)	50	(3)	149
Amortization of net loss	2,975	1,190	8,926	3,570
Amortization of prior service cost	(670)	145	(2,009)	436
Net periodic benefit cost	$ 8,426	$ 6,959	$ 25,278	$ 20,879

Employer contributions

The Company made $10.8 million and $12.8 million in contributions to its U.S. and non-U.S. qualified pension plans during each of the nine months ended March 31, 2004 and 2003, respectively. We anticipate making contributions to the non-U.S. qualified plans of approximately $1.8 million in the fourth quarter of fiscal year 2004. During the fourth quarter of fiscal year 2003, we made additional contributions of $11.5 million to the U.S. and non-U.S. qualified pension plans.

Defined Contribution Plans

We sponsor a savings plan that provides benefits to substantially all U.S. associates. Prior to July 1, 2003, we matched employee contributions at 50 percent of the first 6 percent of total pay, which included base salary, overtime and annual performance-based bonuses. Vesting of the Company match occurs after three years for new employees and is 100 percent for all employees hired before January 1, 1997. Effective July 1, 2003, the Company match has been suspended.

Health Care Benefits

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

Postretirement Benefits

We provide certain health care and life insurance benefits for retired associates. The principal plans cover associates in the U.S. and Canada who have met certain eligibility requirements. Our principal post-retirement benefit plans are unfunded. We accrue a liability for these benefits.

Components of Net Periodic Benefit Cost for Other Postretirement plans

The following table sets forth the components of net periodic benefit cost for the Company s healthcare and post-retirement plans for the three and nine months ended March 31, 2004 and 2003:

	Three Months Ended March 31		Nine Months Ended March 31	
	2004	**2003**	**2004**	**2003**
Service cost	$ 418	$ 442	$ 1,253	$ 1,327
Interest cost	583	629	1,749	1,886
Expected return on plan assets				
Amortization of transition obligation	12	12	35	35
Amortization of net gain	(145)	(129)	(434)	(387)
Amortization of prior service cost	(67)	(116)	(200)	(348)
Net periodic benefit cost	$ 801	$ 838	$ 2,403	$ 2,513

Employer contributions

The Company made $1.9 million in contributions in the form of premiums and medical claim payments to its healthcare and post-retirement plans during each of the nine months ended March 31, 2004 and 2003. We plan to make additional payments estimated to total $0.7 million through the end of June 30, 2004.

Note 6 Targeted Job Reductions

We eliminated approximately 100 positions in our North American region during the first quarter of fiscal year 2004. A charge to earnings of $2.6 million related to these reductions was included in the Company s financial results for the quarter ended September 30, 2003. We eliminated an additional 22 positions in our North American region during the second quarter of fiscal year 2004, resulting in a charge to earnings of $0.7 million in the Company s financial results for the quarter ended December 31, 2003. Of the $3.3 million of total severance charges, $3.2 million was included in Salaries and employee benefits and $0.1 million was included in Professional and subcontracted services during the nine months ended March 31, 2004.

Note 7 Subsequent Events

Subsequent to the end of the third fiscal quarter, the Company completed a tender offer for shares of its Class A common stock, through which the Company purchased 830,802 shares of its Class A shares at a purchase price of $25.25. The aggregate purchase price of the shares purchased through the tender offer was $21.0 million, not including modest fees and expenses.

On April 27, 2004, the Company executed a new lease agreement committing its Washington D.C. office, which includes consulting and corporate operations, to move to northern Virginia. The Company simultaneously provided notice of early termination of its existing Washington D.C. lease which will result in a $3.2 million charge during the fourth quarter of fiscal year 2004. The $3.2 million charge will have no net cash impact on the Company because the Company will receive a $3.2 million payment from the new lessor as an incentive to enter into the new lease.

Note 8 Goodwill and Intangible Assets

The changes in the carrying amount of goodwill for the nine months ended March 31, 2004, are as follows:

	Benefits Group	Technology Solutions Group	Human Capital Group	International	Other	Total
Balance as of June 30, 2003	$ 16,278	$ 1,449	$ 69	$ 979	$ 1,214	$ 19,989
Goodwill recorded during the period				114		114
Translation adjustment	143		3	69		215
Balance as of March 31, 2004	$ 16,421	$ 1,449	$ 72	$ 1,162	$ 1,214	$ 20,318

Goodwill recorded during the period reflects contingent payments made relative to historical acquisitions in Australia and Mexico.

The following table reflects changes in the net carrying amount of the components of intangible assets for the nine months ended March 31, 2004:

	Non-contractual customer relationships	Non-compete agreements	Purchased software	Pension	Total
Balance as of June 30, 2003	$ 480	$ 269	$ 27	$ 113	$ 889
Amortization expense	(150)	(69)	(24)		(243)
Translation adjustment	(10)	(1)		12	1
Balance as of March 31, 2004	$ 320	$ 199	$ 3	$ 125	$ 647

The following table reflects the carrying value of intangible assets at March 31, 2004 and 2003:

	March 31, 2004		March 31, 2003	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortizable intangible assets and intangible pension asset:				
Non-contractual customer relationships	$ 807	$ 487	$ 696	$ 131
Non-compete agreements	672	473	672	380
Purchased software	125	122	125	89
Intangible pension asset	125			
Total intangible assets and intangible pension asset	$ 1,729	$ 1,082	$ 1,493	$ 600

The change in the gross carrying amount of non-contractual customer relationships reflects translation adjustments between March 31, 2003 and March 31, 2004. These intangible assets are denominated in the functional currencies of our subsidiaries outside the United States, and are translated into our reporting currency, the U.S. dollar, based on exchange rates at the balance sheet date.

The weighted average remaining life of amortizable intangible assets at March 31, 2004 was 1.8 years. Estimated amortization expense for fiscal year 2004 and each of the three succeeding fiscal years is as follows:

Fiscal year ending June 30:	Amount
2004	$ 323
2005	300
2006	133
2007	20

Note 9 Earnings Per Share

Basic earnings per share is calculated on the basis of the weighted average number of common shares outstanding during the three and nine months ended March 31, 2004. Diluted earnings per share is calculated on the basis of the weighted average number of common shares outstanding plus the effect of outstanding stock options and employee stock purchase plan shares using the treasury stock method. The components of basic and diluted earnings per share are as follows:

	Three Months Ended March 31		Nine Months Ended March 31	
	2004	2003	2004	2003
Income from continuing operations	$ 13,976	$ 12,441	$ 37,275	$ 37,648
Discontinued operations	613	6,752	639	6,752
Net income	$ 14,589	$ 19,193	$ 37,914	$ 44,400
Weighted average outstanding shares of common stock	32,968	32,942	33,064	32,944
Dilutive effect of employee stock options and employee stock purchase plan shares	320	300	337	333
Common stock and stock equivalents	33,288	33,242	33,401	33,277
Basic earnings per share:				
Income from continuing operations	$ 0.42	$ 0.37	$ 1.13	$ 1.14
Discontinued operations	0.02	0.21	0.02	0.21
Net income	$ 0.44	$ 0.58	$ 1.15	$ 1.35
Diluted earnings per share:				
Income from continuing operations	$ 0.42	$ 0.37	$ 1.12	$ 1.13
Discontinued operations	0.02	0.21	0.02	0.21
Net income	$ 0.44	$ 0.58	$ 1.14	$ 1.34

Note 10 Investment in Affiliates

In January 2003, the FASB issued FASB Interpretation No. 46, Consolidation of Variable Interest Entities, which was later revised in December 2003 (FIN 46R) and effective March 31, 2004 for the Company. This interpretation of Accounting Research Bulletin No. 51, Consolidated Financial Statements, addresses consolidation by business enterprises of variable interest entities. FIN 46R introduces the concept of a variable interest entity and requires consolidation by the primary beneficiary where there is a controlling financial interest in a variable interest entity or where the variable interest entity does not have sufficient equity at risk to finance its activities without additional subordinated financial support from other parties.

Investment in Affiliates consists of equity investments in three entities, Watson Wyatt Holdings (Europe) Limited (WWHE), Watson Wyatt LLP (WWLLP) and Professional Consultants Insurance Company Inc. (PCIC), each of which is accounted for under the equity method. The Company evaluated each of these

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entities based on FIN 46R s criteria in order to determine the applicability of FIN 46R and the Company s current assessment is that of the three entities, WWHE and PCIC are considered to be variable interest entities. The Company has concluded, however, that it does not have a controlling financial interest in WWHE or PCIC and as a result, the Company is not the primary beneficiary and is not required to consolidate their results.

On April 1, 1995, the Company transferred its United Kingdom (U.K.) operations to WWLLP, an actuarial partnership based in the U.K., and received a beneficial interest in WWLLP and a 10% interest in a defined profit pool of WWLLP. The Company also transferred its Continental European operations to WWHE as a newly-formed holding company, jointly owned and controlled by the Company and WWLLP, in exchange for 50.1% of its shares. Effective July 1, 1998, the Company sold one-half of its investment in WWHE to WWLLP. WWHE is now jointly owned and controlled by the Company (25%) and WWLLP (75%). While Watson Wyatt & Company, WWLLP, and WWHE remain separate legal entities, the companies have marketed their services globally under the Watson Wyatt Worldwide brand, sharing resources, technologies, processes and business referrals. Management believes that the Company s maximum financial statement exposure to loss is limited to the carrying value of the Company s investment in WWHE of $6.9 million as of March 31, 2004.

PCIC was organized in 1987 as a captive insurance company under the laws of the State of Vermont. PCIC provides professional liability insurance on a claims-made basis to three actuarial and management consulting firms, all of which participate in the program as both policyholders and stockholders. The Company currently owns 34.8 percent of PCIC. Capital contributions to PCIC are required when approved by a majority of its stockholders. Management believes that the Company s maximum financial statement exposure to loss is limited to the carrying value of the Company s investment in PCIC of $5.7 million, combined with letters of credit totaling $4.9 million for which PCIC has been designated as beneficiary, for a total maximum exposure of $10.6 million.

Note 11 Comprehensive Income

Comprehensive income includes net income, changes in the additional minimum pension liability resulting from translation adjustments and changes in the cumulative translation adjustment gain or loss. For the three months ended March 31, 2004, comprehensive income totaled $15.5 million, compared with $20.4 million for the three months ended March 31, 2003. For the nine months ended March 31, 2004, comprehensive income totaled $42.7 million, compared with $46.1 million for the nine months ended March 31, 2003.

Note 12 Restricted Shares

In conjunction with our initial public offering in October 2000, we entered into agreements providing for transfer restrictions with major stockholders, executive officers and employee directors. During October 2003, these transfer restrictions expired on 1,908,000 Class A shares. As of March 31, 2004, 1,730,000 Class A shares remain restricted. These shares will become freely transferable in October 2004.

Note 13 Guarantees

The Company historically has provided guarantees on an infrequent basis to third parties in the ordinary course of business. The guarantees described below are currently in effect and could require the Company to make payments to third parties under certain circumstances.

Letters of Credit. The Company has two outstanding letters of credit totaling $7.5 million under our existing credit facility to guarantee payment to beneficiaries in the event that the Company fails to meet its financial obligations to these beneficiaries. One letter of credit for $2.6 million will expire in October 2006, while the second letter of credit for $4.9 million will remain outstanding as long as we retain an ownership share of our affiliated captive insurance company, PCIC. The estimated fair market value of these letters of credit is nominal because they have never been used, and the Company believes that future usage is remote.

Affiliate Agreements. In 1995, we entered into an alliance agreement with R. Watson & Sons, a United Kingdom-based actuarial, benefits and human resources consulting partnership (now WWLLP), the predecessor of which was founded in 1878. Included in the agreements between the Company and WWLLP (the Alliance Agreements) are various indemnities and guarantees relating to the performance of the Company and its subsidiaries, some of which became part of WWHE, as to such matters as tax liabilities, liabilities for prior acts or omissions arising from the operation of the UK and European businesses prior to the alliance and failure to perform various obligations under the Alliance Agreements. In addition, certain events, such as a sale of material parts of our business, could require the Company to either purchase from or sell to WWLLP an interest in our European business and/or repurchase the shares of the Company s stock currently held by WWLLP. The Company is unable to estimate an amount of any potential future payments under these contractual arrangements because the potential occurrence of any of the events to which the indemnities apply is entirely speculative, there is no history of payments and the dollar amount, if any, would be dependent upon the nature of the event triggering such indemnity. Management believes that any potential for payment under such indemnities and guarantees should decline with the passage of time. There are no provisions for recourse to third parties, nor are any assets held by any third parties that the Company as guarantor can liquidate to recover amounts paid under such indemnities.

The Company owns 25 percent of WWHE and WWLLP owns the remaining 75 percent. Additional capital for WWHE, if required, may be provided by both owners based on their respective ownership interests. If either the Company or WWLLP does not provide its pro rata share of any additional capital invested in WWHE, that party s respective ownership interest will be reduced accordingly.

In connection with the establishment of our alliance with WWLLP, the Company agreed to guarantee WWLLP s performance under a lease for office space in London that expires in 2015. Payments by WWLLP under the lease total approximately £1.4 million (or approximately $2.6 million based on the March 31, 2004, exchange rate) per year. We also granted WWLLP an option to return the leased space to our UK subsidiary in 2009. If WWLLP exercises this option, the Company would attempt to sublease the space at the then-current market rates.

Indemnification Agreements. The Company has various agreements that provide that it may be obligated to indemnify the other party with respect to certain matters. Generally, these indemnification clauses are included in contracts arising in the normal course of business and in connection with the purchase and sale of certain businesses. Although it is not possible to predict the maximum potential amount of future payments under these indemnification agreements due to the conditional nature of the Company s obligations and the unique facts of each particular agreement, the Company does not believe that any potential liability that might arise from such indemnity provisions is probable or material. There are no provisions for recourse to third parties, nor are any assets held by any third parties that any guarantor can liquidate to recover amounts paid under such indemnities.

Wellspring Leases. We continue to guarantee three leases for office premises for Wellspring Resources, LLC (Wellspring), the benefits administration outsourcing business that we exited from in fiscal year 1998. At March 31, 2004, minimum remaining payments guaranteed under these leases, which expire at various dates through 2007, total $19.7 million, excluding anticipated future sublease income. See Note 15 for more information regarding our obligation to guarantee Wellspring s leases.

Note 14 Contingent Liabilities

From time to time, we are a party to various lawsuits, arbitrations or mediations that arise in the ordinary course of business. These disputes typically involve claims relating to the rendering of professional services or employment matters. Management believes, based on currently available information, that the results of all pending claims against us will not have a material adverse affect on the Company. The matters reported on below involve the most significant pending or potential claims against us. These matters did not significantly impact the quarter s financial results.

New Jersey Coalition of Auto Retailers Insurance Group Trust (NJCAR). The claims have been settled and the suit has been dismissed.

Toussaint, et al. v. James, et al. The claim has been settled and the suit has been dismissed.

Iron Workers Local 25 et al. v. Watson Wyatt & Co. On April 19, 2004, Watson Wyatt & Co. was served with a complaint filed by a former client in the United States District Court for the Eastern District of Michigan. The complaint alleges negligence and negligent supervision in the preparation of an actuarial valuation. The amount of damages sought are not specified.

Note 15 Discontinued Operations

As discussed in Note 13, the Company continues to guarantee three leases for office premises for Wellspring. Through the first nine months of fiscal year 2004, the Company received sublease income of approximately $79,000 in excess of lease payments related to this business. Since the second quarter of fiscal year 2003, the leases have been generating positive cash flows of approximately $0.1 million per fiscal year.

During the third quarter of fiscal years 2003 and 2004, the Company evaluated its accrual for the estimated remaining future obligations and costs related to the exit from Wellspring. The evaluations included an analysis of occupancy rates of Wellspring, along with an analysis of real estate market conditions in cities in which the leases exist and an assessment of probable future sublease income for these leases. As a result of the analysis performed during fiscal years 2003 and 2004, the Company reduced its accrual by $14.7 million and $1.0 million, respectively, less the associated income tax expenses. Such adjustments are reflected in the Consolidated Statement of Operations for the third quarter of fiscal years 2003 and 2004 in the line Adjustment to reduce estimated loss on disposal of discontinued operations. The remaining noncurrent liability of $3.0 million represents management s estimate of potential future cash outflows related to guarantees associated with Wellspring leases.

Note 16 Recent Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities, which clarifies the financial reporting guidance associated with the consolidation of another entity. Immediate consolidation requirements of FIN 46 were not applicable to the Company since the Company did not create variable interest entities after January 31, 2003. In December 2003, the FASB revised and superceded FIN 46 with the issuance of FIN 46R in order to address certain implementation issues. The Company adopted FIN 46R effective March 31, 2004. See Note 10 regarding the adoption of FIN 46R.

Emerging Issues Task Force Issue 00-21, Revenue Arrangements with Multiple Deliverables (EITF 00-21), was effective for the Company beginning July 1, 2003. Beginning July 1, 2003, the Company has applied such requirements prospectively to multiple deliverable arrangements, which include arrangements involving installation and customization of technology solution products sold together with on-going services offered by the Company. Based on the types of arrangements entered into historically, the Company does not expect that adoption of

EITF 00-21 will have a material effect on the accounting for such arrangements.

In December 2003, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 104 (SAB 104), Revenue Recognition, which supercedes Staff Accounting Bulletin No. 101 (SAB 101), Revenue Recognition in Financial Statements. SAB 104 s primary purpose is to rescind accounting guidance contained in SAB 101 related to multiple element revenue arrangements, superceded as a result of the issuance of EITF 00-21. While the wording of SAB 104 has changed to reflect the issuance of EITF 00-21, the revenue recognition principles of SAB 101 remain largely unchanged by the issuance of SAB 104. The issuance of SAB 104 has not had an effect on our revenue recognition policies as they are in accordance with SAB 104.

In December 2003, the Financial Accounting Standards Board issued FASB Staff Position (FSP) No. FAS 106-1 - Accounting and Disclosure Requirements Related to the Medicare Prescription Drug Improvement and Modernization Act of 2003 (the Act) (FAS 106-1). The Act includes a prescription drug benefit under Medicare Part D as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent (as defined in the Act) to Medicare Part D. In accordance with FAS 106-1, the Company has elected to defer the recognition of the effects of the Act on the consolidated financial statements until pending authoritative guidance on the federal subsidy is issued by the FASB. As a result, measures of the net periodic cost of our post-retirement plans included in the Financial Statements and accompanying Notes do not include the effect of FAS 106-1 on the plans. The Company does not believe that adoption of FAS 106-1 will have a material effect on the financial condition of the Company.

Note 17 Adoption of Amendments to the ESPP

In August 2001, the Board of Directors adopted the Company s 2001 Employee Stock Purchase Plan (the ESPP), which subsequently was approved by the stockholders in November 2001. The ESPP is intended to provide employees of the Company with additional incentives by permitting them to acquire a proprietary interest in the Company through the purchase of shares of the Company s common stock. An additional 1,500,000 shares of common stock were authorized and reserved for issuance under the ESPP at the 2003 Annual Meeting of Stockholders in November 2003.

Note 18 Professional Consultants Insurance Company (PCIC) Other Non-operating Gain

On July 9, 2003, the Board of Directors of PCIC, a captive insurance company of which we own 34.8 percent, decided to pass on to each of its owners a credit in their 2003-04 policy year in connection with benefits received from an aggregate stop loss insurance policy entered into by PCIC. PCIC s Board of Directors determined that this credit would be used to offset all or a portion of each insured s obligation to PCIC for historical loss experience. As a result, the Company recorded a $5.6 million pre-tax non-operating gain in the first quarter of fiscal year 2004 and included this gain in Other non-operating income in the Consolidated Statements of Operations.

As a result of this gain, the Company also recorded a $5.6 million supplemental bonus accrual in the first quarter of fiscal year 2004 that is incremental to the Company s fiscal year end bonus, but will be paid in September 2004 with the regular bonus cycle. This supplemental bonus is included in Salaries and employee benefits.

Note 19 Sale of U.S.-based Public Sector Retirement Business

In fiscal year 2002, we sold our U.S.-based public sector retirement business to Gabriel, Roeder, Smith & Company (GRS). The future consideration from the sale of the U.S.-based public sector retirement business is contingent upon the successful transition of certain clients to GRS and upon their retention by GRS. Simultaneous with the sale, we entered into an alliance agreement with GRS under which we will mutually refer future business opportunities and explore joint consulting assignments.

In accordance with the terms of the sale, GRS paid the Company $0.5 million of contingent payments in each of the first quarters of fiscal years 2003 and 2004. The amount of additional contractual cash payments over the upcoming three fiscal years is also contingent upon the successful transition of certain clients to GRS and upon their retention by GRS.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

Watson Wyatt & Company Holdings, including its subsidiaries, is a global human capital consulting firm. We help our clients enhance business performance by improving their ability to attract, retain and motivate qualified employees. We focus on delivering value-added consulting services that help our clients anticipate, identify and capitalize on emerging opportunities in human capital management. We implement this strategy through 3,880 associates in 61 offices located in 18 countries.

As leading economies worldwide become more services-oriented, human capital has become increasingly important to companies and other organizations. The heightened competition for skilled employees, unprecedented changes in workforce demographics, regulatory changes related to compensation and retiree benefits and rising employee-related costs have increased the importance of effective human capital management. We help our clients address these issues by combining our expertise in human capital management with consulting and technology, to improve the design and implementation of various human resources, or HR, programs, including compensation, retirement and health care plans.

General

As of March 31, 2004, we employed 3,880 associates as follows:

Benefits Group	1,635
Technology Solutions Group	330
Human Capital Group	150
International	965
Other (including Data Services & Communication)	575
Corporate	225
Total	3,880

Principal Services

We design, develop and implement HR strategies and programs through the following closely-interrelated practice areas:

Benefits Group	**Technology Solutions Group**	**Human Capital Group**
Retirement plans, including pension, 401(k) and executive benefits plans	Web-based applications for health and welfare, pension and compensation administration	Compensation plans, including broad-based and executive compensation, stock and other long-term incentive programs
Health care, disability and other group benefit plans	Call center strategy, design and tools	Strategies to align workforce performance with business objectives
Investment consulting services to pension plans	Strategic, research-based HR technology and service delivery consulting	Organization effectiveness consulting, including talent management, through organization and employee research
Global compensation, benefits, expatriate and HR practice strategy, implementation and administration	Targeted online compensation and benefits statements, content management and call center case management solutions	Strategies for attracting, retaining and motivating employees
Actuarial services		Performance management
Strategic workforce planning		

Our clients include many of the world s largest corporations as well as emerging growth companies, public institutions and nonprofit organizations.

International Operations

Outside of North America, our consultants, working in Asia-Pacific and Latin America, operate on a geographic basis from 25 offices in 16 countries and provide consulting services in the practice areas described above.

Other

While we focus our consulting services in the areas described above, management believes that one of our primary strengths is our ability to draw upon consultants from our different practices to deliver integrated services to meet the needs of our clients.

Watson Wyatt Worldwide Alliance

Recognizing our clients need for consulting services worldwide, in the late 1970s we established operations throughout Europe by acquiring local firms and opening new offices. In 1995, in response to the rapidly increasing globalization of the world economy, we made a strategic decision to strengthen our European capabilities significantly and extend our global reach. We entered into an alliance with R. Watson & Sons (which subsequently became Watson Wyatt Partners, now Watson Wyatt LLP), a leading United Kingdom-based actuarial, benefits and human resources consulting partnership founded in 1878. Since 1995, we have marketed our services globally under the Watson Wyatt Worldwide brand, sharing resources, technologies, processes and business referrals with Watson Wyatt LLP.

The Watson Wyatt Worldwide alliance maintains 88 offices in 30 countries and employs over 6,000 associates. Watson Wyatt & Company Holdings operates 61 offices in 18 countries in North America, Latin America and Asia-Pacific. Watson Wyatt LLP operates 10 offices in the United Kingdom and

Ireland, and also operates 1 office engaged in the insurance and financial services business in the United States. The alliance operates 16 offices in 10 continental European countries, principally through a jointly-owned holding company, Watson Wyatt Holdings (Europe) Limited. Watson Wyatt & Company owns 25 percent of the holding company; Watson Wyatt LLP owns 75 percent.

Financial Statement Overview

Watson Wyatt s fiscal year ends June 30. The financial statements contained in this quarterly report include Consolidated Balance Sheets as of the end of the third quarter of fiscal year 2004 (March 31, 2004) and as of the end of fiscal year 2003 (June 30, 2003), Consolidated Statements of Operations for the three and nine month periods ended March 31, 2004 and 2003, Consolidated Statements of Cash Flows for the nine month periods ended March 31, 2004 and 2003 and a Consolidated Statement of Changes in Stockholders Equity for the nine month period ended March 31, 2004.

We operate globally as an alliance with our affiliates. However, the revenues and operating expenses in the Consolidated Statements of Operations reflect solely the results of operations of Watson Wyatt & Company Holdings. Our share of the results of our affiliates, recorded using the equity method of accounting, is reflected in the Income from affiliates line. Our affiliates are Watson Wyatt LLP, Watson Wyatt Holdings (Europe) Limited and Professional Consultants Insurance Company, Inc. (PCIC), our captive insurance company.

We derive substantially all of our revenue from fees for consulting services, which generally are billed based on time and materials or on a fixed-fee basis. Clients are typically invoiced on a monthly basis with revenue generally recognized as services are performed. For the most recent three fiscal years, revenue from U.S. consulting operations has comprised approximately 80 percent of consolidated revenue. No single client accounted for more than 4 percent of our consolidated revenue for any of the most recent three fiscal years.

In delivering consulting services, our principal direct expenses relate to compensation of personnel. Salaries and employee benefits are comprised of wages paid to associates, related taxes, benefit expenses such as pension, medical and insurance costs and fiscal year-end discretionary bonuses.

Professional and subcontracted services represent fees paid to external service providers for employment, marketing and other services. For the most recent three fiscal years, approximately 60 percent of these professional and subcontracted services were directly incurred on behalf of our clients and were reimbursed by them, with such reimbursements being included in revenue.

Occupancy, communications and other expenses represent expenses for rent, utilities, supplies and telephone to operate office locations as well as non-client-reimbursed travel by associates, publications and professional development.

General and administrative expenses include the operational costs and professional fees paid by corporate management, general counsel, marketing, human resources, finance, research, technology support and professional liability insurance.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Our estimates, judgments and assumptions are continually evaluated based on available information and experience. Because of the use of estimates inherent in the financial reporting process, actual results could differ from those estimates.

We have reviewed the accounting estimates used in the preparation of our financial statements and have determined that the following accounting policies are critical to the understanding of the use of estimates in the Company s financial statements:

Revenue Recognition

Revenue includes fees primarily generated from consulting services provided in the areas of employee benefits, human capital strategies and related technology solutions. We recognize revenue from these consulting engagements either on a time-and-materials basis or on a fixed-fee basis, depending on the terms and conditions defined at the inception of an engagement with a client.

Revenue is recognized on time-and-materials engagements based on billable rates times hours worked plus expenses incurred. For fixed-fee arrangements, revenue is also recognized based on billable rates times hours worked plus expenses incurred. However, for significant fixed-fee engagements in our Technology Solutions Group, we periodically review ongoing engagements in order to assess the accuracy of our estimates-to-complete. Revenue recognition for fixed-fee engagements is affected by a number of factors including a change in the estimated amount of effort required to complete the project, changes in scope, the staffing on the engagement and/or the level of client participation. This review requires us to make judgments and estimates regarding the overall profitability and stage of project completion which, in turn, affect how we recognize revenue. To the extent that our estimates change for a particular engagement, we record the cumulative effect of the change in the period in which it becomes known. The Company recognizes a loss on an engagement when estimated revenue to be received for that engagement is less than total estimated direct and indirect costs associated with the engagement. Losses are recognized in the period in which the loss becomes probable and the amount of the loss is reasonably estimable.

The Company has developed various software programs and technologies that are provided to clients in connection with consulting services. We generally recognize revenue for such services as time is incurred because the services are considered essential to the functionality of the software. Software developed to be utilized in providing services to a client, but for which the client does not have the contractual right to take possession, is capitalized in accordance with the AICPA s Statement of Position 98-1 Accounting for the Costs of Computer Software Developed or Obtained for Internal Use and any revenue associated with the related contract is recognized over the service period.

Revenue recognized in excess of billings is recorded as unbilled accounts receivable. Cash collections in excess of revenue recognized are recorded as deferred revenue until the revenue recognition criteria are met. Client reimbursable expenses, including those relating to travel, other out-of-pocket expenses, and any third-party costs, are included in revenue, and an equivalent amount of reimbursable expenses are included in professional and subcontracted services as a cost of revenue.

Emerging Issues Task Force Issue 00-21, Revenue Arrangements with Multiple Deliverables (EITF 00-21), was effective for the Company beginning July 1, 2003. Beginning July 1, 2003, the Company has applied such requirements prospectively to multiple deliverable arrangements, which include arrangements involving installation and customization of technology solution products sold together with on-going services offered by the Company. The adoption of EITF 00-21 has not had a material effect on the Company s financial performance or condition.

Valuation of Billed and Unbilled Receivables from Clients

We maintain allowances for doubtful accounts to reflect estimated losses resulting from our clients   failure to pay for our services after the services have been rendered, including allowances when customer disputes may exist. The related provision is recorded as a reduction to revenue. Our allowance policy is based on the aging of our billed and unbilled client receivables and has been developed based on our write-off history. Facts and circumstances such as the average length of time the receivables are past due, general market conditions, current economic trends and our client s ability to pay may cause fluctuations in our valuation of billed and unbilled receivables.

Discretionary Compensation

The Company s compensation program includes a discretionary annual bonus that is determined by management and paid once per fiscal year in the form of cash and/or deferred stock units after the Company s annual operating results are finalized.

An estimated annual bonus amount is initially developed at the beginning of each fiscal year in conjunction with our budgeting process. Quarterly, estimated annual operating performance is reviewed by the Company and the discretionary annual bonus amount is then adjusted, if necessary, by management to reflect changes in the forecast of pre-bonus profitability for the year. After determining the estimated annual bonus amount, the bonus is then allocated to remaining quarterly reporting periods as a constant percentage of estimated pre-bonus profitability. In those quarters where the estimated annual bonus level changes, the remaining estimated annual bonus is accrued over the remaining quarters as a constant percentage of estimated future pre-bonus profitability. Annual bonus levels may vary from current expectations as a result of changes in the Company s forecast of pre-bonus profitability and competitive employment market conditions.

As a result of a $5.6 million pre-tax non-operating gain recorded in the first quarter of fiscal year 2004, the Company recorded a $5.6 million supplemental bonus accrual in the first quarter that is incremental to the Company s fiscal year end bonus. This supplemental bonus amount, which will be paid out in September 2004 with the regular bonus cycle, is included in Salaries and employee benefits.

Income Taxes

Determining the consolidated provision for income tax expense, deferred tax assets and liabilities and the related valuation allowance involves judgment. As a global company with offices in 18 countries, we are required to calculate and provide for estimated income tax liabilities for each of the tax jurisdictions in which we operate. This process involves estimating current tax obligations and exposures in each jurisdiction as well as making judgments regarding the future recoverability of deferred tax assets. Tax costs can involve complex issues and may require an extended period to resolve. Changes in the geographic mix or estimated level of annual pre-tax income, limitations on the use of the Company s foreign subsidiary losses, changes in tax laws and changes resulting from tax audits can all affect the overall effective income tax rate, which, in turn, impacts the overall level of income tax expense and net income.

Pension Assumptions

We sponsor both qualified and non-qualified, non-contributory defined benefit pension plans covering substantially all of our associates. Under our principal plans (United States, Canada, Hong Kong and the United Kingdom), benefits are based on our associates years of service and compensation during the three highest-paid consecutive years of service.

Determination of our obligations and annual expense under the plans is based on a number of assumptions that, given the longevity of the plans, are long-term in focus. A change in one or a combination of these assumptions could have a material impact on our pension benefit obligation and related expense. For this reason, management employs a long-term view so that assumptions do not change frequently in response to short-term volatility in the economy. Any difference between actual and assumed results is amortized into our pension expense over the average remaining service period of participating employees. We consider several factors prior to the start of each fiscal year when determining the appropriate annual assumptions, including economic forecasts, historical trends, portfolio composition and peer comparisons.

The following assumptions were used at the end of the past three fiscal years in the valuation of our U.S. plan, which comprises the majority of the principal defined benefit pension plans:

	Year Ended June 30		
	2003	2002	2001
Discount rate	6.00%	7.25%	7.25%
Expected long-term rate of return on assets	9.00%	10.00%	10.00%
Rate of increase in compensation levels	3.09%	4.34%	5.34%

The 6.00 percent discount rate assumption used at the end of fiscal year 2003 represents a 125 basis point reduction from the 7.25 percent discount rate used at the end of fiscal years 2002 and 2001. The Company s 2003 discount rate assumption was determined by matching future pension benefit payments with expected future AA bond yields for the same periods.

The expected long-term rate of return on assets assumption was lowered to 9.00 percent at the end of fiscal year 2003 from 10.00 percent at the end of fiscal years 2002 and 2001. Selection of the 9.00 percent return assumption was supported by an analysis performed by the Company of the weighted average yield expected to be achieved with the anticipated makeup of investments. The investment makeup is heavily weighted towards equities. The return on assets through the first nine months of fiscal year 2004 has been 14.0%, compared to a return of (13.0)% in fiscal year 2003.

During fiscal year 2003, the value of the assets held in the pension plans decreased and the decline in interest rates increased our accumulated benefit obligation, resulting in the accumulated benefit obligation becoming greater than the value of the plan assets for the U.S. and U.K. pension plans. The Company was therefore required to record an additional minimum pension liability for those plans at June 30, 2003, in accordance with Statement of Financial Accounting Standards No. 87 Employers Accounting for Pensions (FAS 87). This resulted in an increase in the pension liability of $113.4 million, an increase in intangible assets of $0.1 million, a non-cash charge to Stockholders Equity of $67.9 million (reflected in accumulated other comprehensive loss) and an increase in deferred tax assets of $45.4 million as of June 30, 2003. A market recovery in future periods, and/or an increase in long-term interest rates, could reverse a portion or all of this charge. Alternatively, future market declines and/or a decrease in long-term interest rates would result in an addition to this amount. Our Canadian and Hong Kong pension plan assets were greater than their associated accumulated benefit obligation as of June 30, 2003, and thus did not require the recording of additional minimum pension liabilities.

Incurred But Not Reported Claims

The Company uses actuarial assumptions to estimate and record a liability for incurred but not reported (IBNR) professional liability claims and engaged an external actuarial firm to assist in the calculation of these estimates. Our estimated IBNR liability is based on long-term trends and averages, and considers a number of factors, including changes in claim reporting patterns, claim settlement patterns, judicial decisions, and legislation and economic decisions, but excludes the effect of claims data for large cases due to the insufficiency of actual experience with such cases. Management does not currently expect significant fluctuations in the IBNR liability, based on the Company s historical claims experience. However, our estimated IBNR liability will fluctuate if claims experience changes over time.

Results of Operations

The table below sets forth Consolidated Statements of Operations data for continuing operations as a percentage of revenue for the periods indicated:

	Three Months Ended March 31		Nine Months Ended March 31	
	2004	2003	2004	2003
Revenue	100.0%	100.0%	100.0%	100.0%
Costs of providing services:				
Salaries and employee benefits	55.5	56.7	57.4	56.4
Professional and subcontracted services	6.4	6.5	6.4	6.7
Occupancy, communications and other	15.7	15.4	14.9	14.9
General and administrative expenses	8.5	7.7	8.8	8.1
Depreciation and amortization	2.3	2.7	2.7	2.9
	88.4	89.0	90.2	89.0
Income from operations	11.6	11.0	9.8	11.0
Income from affiliates	1.3	0.8	0.9	0.8
Interest income, net		0.1	0.1	0.1
Other non-operating income			1.2	0.1
Income from continuing operations before income taxes	12.9	11.9	12.0	12.0
Provision for income taxes	5.2	4.9	4.9	4.9
Income from continuing operations	7.7%	7.0%	7.1%	7.1%

Three and Nine Months Ended March 31, 2004, Compared to the Three and Nine Months Ended March 31, 2003

Executive Overview

Revenues for the quarter were up 2% from the third quarter of fiscal year 2003, reflecting accelerating growth in our Retirement business due to new client wins and modest revenue growth for existing clients. Our Technology Solutions Group s backlog continues to increase as its rate of revenue decline moderates. The Human Capital Group s profitability doubled on strong executive compensation growth, although weaker performance was experienced in other parts of the practice.

Expenses continue to decline as a result of the Company s cost reduction efforts, affecting expense categories such as salaries, employee benefits, rent, and office supplies. These reductions have been partially offset by increased pension and professional liability insurance expense.

Revenue

Revenue from operations for the third quarter of fiscal year 2004 was $180.7 million, compared to $177.6 million for the third quarter of fiscal year 2003, an increase of $3.1 million or 2 percent.

The Benefits Group increased revenue by $6.0 million or 6 percent during the third quarter of fiscal year 2004 as we continued to benefit from a large number of new client wins and grow revenues with existing clients, in part due to consulting associated with continuing legislative activity regarding cash balance plans and pension funding assumptions. Revenue from our Technology Solutions Group decreased by

$2.2 million or 10 percent, a better than expected performance for the quarter that reflects new client wins during the previous quarter. Revenue from our Human Capital Group decreased $0.6 million or 5 percent. Our revenues in this segment continue to be largely driven by increased work in our executive compensation business, offset by a decrease in demand for general organization effectiveness consulting. Our international segment finished the quarter with revenue growth of $3.0 million or 16 percent, reflecting favorable exchange rates and improved results in Australia and Mexico. Revenue for other practice areas in North America decreased by $1.0 million or 9 percent during the third quarter of fiscal year 2004.

Revenue from operations for the first nine months of fiscal year 2004 was $522.0 million, compared to $531.2 million for the first nine months of fiscal year 2003, a decrease of $9.2 million or 2 percent.

The Benefits Group increased revenue by $11.2 million or 4 percent during the first nine months of fiscal year 2004 due to new client wins, as well as growth in existing clients. Revenue from our Technology Solutions Group decreased by $12.9 million or 17 percent, which the Company believes reflects a lag between when a company s results improve and when it is willing to spend large amounts on discretionary projects. Revenue from our Human Capital Group decreased $2.0 million or 6 percent during the first nine months of fiscal year 2004, reflecting increased demand in executive compensation offset by weak results in organization effectiveness consulting. Our international segment finished the nine months with fiscal year to date revenue growth of $4.2 million or 7 percent. However, revenue was down one percent after adjusting for the impact of the weakening U.S. dollar. Revenue for other practice areas in North America decreased by $4.4 million or 12 percent during the first nine months of fiscal year 2004.

Salaries and Employee Benefits

Salaries and employee benefit expenses for the third quarter of fiscal year 2004 were $100.2 million, compared to $100.6 million for the third quarter of fiscal year 2003, a decrease of $0.4 million. The decrease was mainly due to lower benefits costs of $2.2 million, which reflect the suspension of the Company match on our defined contribution retirement plan and lower health care costs to the Company, and lower salaries of $0.4 million, which reflect the Company s targeted job reductions net of modest salary increases. These decreases were partially offset by a higher accrual for discretionary compensation of $1.5 million and higher pension and post retirement expenses of $1.0 million. As a percentage of revenue, salaries and employee benefits decreased from 56.7 percent to 55.5 percent.

Salaries and employee benefit expenses for the first nine months of fiscal year 2004 were $299.7 million, compared to $299.9 million for the first nine months of fiscal year 2003, a decrease of $0.2 million. Salaries and employee benefit expenses for the first nine months of fiscal year 2004 include severance charges of $3.9 million related to job reductions in North America. The decrease, exclusive of this charge, was mainly due to lower benefits costs of $7.2 million, which reflect the suspension of the Company match on our defined contribution retirement plan and health care costs to the Company, and lower salaries of $2.6 million, which reflect the Company s targeted job reductions net of modest salary increases. These decreases are partially offset by higher pension and post-retirement expenses of $3.9 million and a higher accrual for discretionary compensation of $1.4 million. As a percentage of revenue, salaries and employee benefits increased from 56.4 percent to 57.4 percent.

Professional and Subcontracted Services

Professional and subcontracted services used in consulting operations for the third quarters of fiscal years 2004 and 2003 were $11.6 million. As a percentage of revenue, professional and subcontracted services decreased from 6.5 percent to 6.4 percent.

Professional and subcontracted services used in consulting operations for the first nine months of fiscal year 2004 were $33.3 million, compared to $35.4 million for the first nine months of fiscal year 2003, a decrease of $2.1 million or 6 percent. The decrease in both periods resulted from lower reimbursable expenses incurred on behalf of clients and continued cost control measures. As a percentage of revenue, professional and subcontracted services decreased from 6.7 percent to 6.4 percent.

Occupancy, Communications and Other

Occupancy, communications and other expenses for the third quarter of fiscal year 2004 were $28.4 million, compared to $27.3 million for the third quarter of fiscal year 2003, an increase of $1.1 million or 4 percent. The increase was mainly due to higher travel and business tax expenses. As a percentage of revenue, occupancy, communications and other increased from 15.4 percent to 15.7 percent.

Occupancy, communications and other expenses for the first nine months of fiscal year 2004 were $77.9 million, compared to $79.4 million for the first nine months of fiscal year 2003, a decrease of $1.5 million or 2.0 percent. The decrease reflects the Company s cost containment measures, as evidenced through lower expenses in many categories including office supplies, telephone and promotional expenses. As a percentage of revenue, occupancy, communications and other remained at 14.9 percent.

Occupancy, communication and other expenses in the fourth quarter of fiscal year 2004 will include a $3.2 million charge resulting from a lease termination as further described below under Off-Balance Sheet Arrangements and Contractual Obligations Operating Leases.

General and Administrative Expenses

General and administrative expenses for the third quarter of fiscal year 2004 were $15.3 million, compared to $13.7 million for the third quarter of fiscal year 2003, an increase of $1.6 million or 12 percent. As a percentage of revenue, general and administrative expenses increased from 7.7 percent to 8.5 percent.

General and administrative expenses for the first nine months of fiscal year 2004 were $45.9 million, compared to $42.9 million for the first nine months of fiscal year 2003, an increase of $3.0 million or 7 percent. As a percentage of revenue, general and administrative expenses increased from 8.1 percent to 8.8 percent. The increase in both periods is mainly due to higher insurance costs and expenses associated with compliance with the Sarbanes-Oxley Act of 2002 and related SEC rules.

Depreciation and Amortization

Depreciation and amortization for the third quarter of fiscal year 2004 was $4.1 million, compared to $4.9 million for the third quarter of fiscal year 2003, a decrease of $0.8 million or 16 percent. As a percentage of revenue, depreciation and amortization decreased from 2.7 percent to 2.3 percent.

Depreciation and amortization for the first nine months of fiscal year 2004 was $14.1 million, compared to $15.2 million for the first nine months of fiscal year 2003, a decrease of $1.1 million or 7 percent. The decrease in both periods is mainly due to lower capital asset purchases in fiscal years 2002 and 2003. As a percentage of revenue, depreciation and amortization decreased from 2.9 percent to 2.7 percent.

Income From Affiliates

Income from affiliates for the third quarter of fiscal year 2004 was $2.3 million, compared to $1.3 million for the third quarter of fiscal year 2003, an increase of $1.0 million or 77 percent. The increase was due to the Company s interest in higher operating results of Watson Wyatt LLP of $1.5 million and higher equity income of PCIC of $0.2 million, partially offset by the Company s interest in lower operating results of Watson Wyatt Holdings (Europe) Limited (WWHE) of $0.8 million.

Income from affiliates for the first nine months of fiscal year 2004 was $5.1 million, compared to $4.2 million for the first nine months of fiscal year 2003, an increase of $0.9 million or 21 percent. The increase was due to the Company s interest in higher operating results of Watson Wyatt LLP of $0.9 million and WWHE of $0.3 million, partially offset by lower equity income of PCIC of $0.5 million.

Interest Income, Net

Interest income, net for the third quarter of fiscal year 2004 was $20,000, compared to $0.2 million for the third quarter of fiscal year 2003. Interest income, net for the first nine months of fiscal year 2004 was $0.4 million, compared to $0.6 million for the first nine months of fiscal year 2003, a decrease of $0.2 million or 33 percent.

Other Non-operating Income

Other non-operating income for the first nine months of fiscal year 2004 was $6.2 million, which is principally attributable to the $5.6 million non-operating gain the Company recorded related to PCIC. See Note 18 of the Notes to the Consolidated Financial Statements for more information about this non-operating gain. During the first nine months of fiscal years 2004 and 2003, the Company also received cash payments of $0.6 million in connection with the fiscal year 2002 sale of our U.S.-based public retirement business to GRS. All payments received in connection with this sale were contingent upon the successful transition of certain clients to GRS and upon their retention by GRS.

Provision for Income Taxes

Provision for income taxes for the first nine months of fiscal year 2004 was $25.6 million, compared to $26.2 million for the first nine months of fiscal year 2003. Our effective tax rate was 40.7 percent for the first nine months of fiscal year 2004 and 41.0 percent for the first nine months of fiscal year 2003.

Income From Continuing Operations

Income from continuing operations for the third quarter of fiscal year 2004 was $14.0 million, compared to $12.4 million for the third quarter of fiscal year 2003, an increase of $1.6 million or 13 percent. As a percentage of revenue, income from continuing operations increased from 7.0 percent to 7.7 percent. Income from continuing operations for the first nine months of fiscal year 2004 was $37.3 million, compared to $37.6 million for the first nine months of fiscal year 2003, a decrease of $0.3 million or 1 percent. As a percentage of revenue, income from continuing operations remained at 7.1 percent.

Earnings Per Share, Income From Continuing Operations

Diluted earnings per share, income from continuing operations for the third quarter of fiscal year 2004 was $0.42, compared to $0.37 for the third quarter of fiscal year 2003. Diluted earnings per share, income from continuing operations for the first nine months of fiscal year 2004 was $1.12, compared to $1.13 for the first nine months of fiscal year 2003.

Discontinued Operations

Through the first nine months of fiscal year 2004, the Company received sublease income of approximately $79,000 in excess of lease payments related to Wellspring.

Also, discontinued operations for the third quarter of fiscal years 2004 and 2003 reflect the reduction of the Company s accrual for the estimated remaining future obligations and costs related to the exit from Wellspring by $1.0 million and $14.7 million, respectively, less the associated income tax expenses. See Note 15 of the Notes to the Consolidated Financial Statements for more information related to Wellspring.

Liquidity and Capital Resources

Our cash and cash equivalents at March 31, 2004 totaled $153.7 million, compared to $144.4 million at June 30, 2003, representing an increase of $9.3 million. The increase in cash from June 30, 2003 to March 31, 2004 follows a typical pattern of cash flows for the Company that is attributable to the payment of bonuses in the first fiscal quarter related to the prior year s fiscal year-end bonus accrual.

During the first nine months of fiscal year 2004, we paid $34.9 million in previously accrued discretionary compensation, $31.5 million in corporate taxes and contributed $10.0 million to our U.S. defined benefit pension plan. These outflows of cash were offset by positive cash flow from consulting operations. Consistent with the Company s liquidity position, management considers various alternative strategic uses of cash reserves including acquisitions, dividends and stock buybacks, or any combination of these options.

Our non-U.S. operations do not materially impact liquidity or capital resources as they are substantially self-sufficient for their working capital needs. At March 31, 2004, $25.4 million of the total cash balance of $153.7 million was held outside of North America, which we have the ability to utilize, if necessary. There are no significant restrictions other than local or U.S. taxes associated with repatriation.

Cash From Operating Activities

Cash from operating activities for the first nine months of fiscal year 2004 was $24.7 million, compared to cash from operating activities of $43.5 million for the first nine months of fiscal year 2003. The variance is mainly due to higher receivables from clients of $13.8 million, higher corporate tax payments of $5.5 million and higher payments to retirees of $5.6 million, partially offset by a lower payment of discretionary compensation of $13.5 million.

The allowance for doubtful accounts increased $1.6 million and the allowance for work in process increased $0.4 million from June 30, 2003, to March, 31, 2004. The number of days of accounts receivable and work in process outstanding was 78 at March 31, 2004, compared to 72 at June 30, 2003 and 76 at March 31, 2003.

Cash Used in Investing Activities

Cash used in investing activities for the first nine months of fiscal year 2004 was $11.9 million, compared to $14.8 million for the first nine months of fiscal year 2003. The decrease can be primarily attributed to a $2.0 million investment in affiliates in fiscal year 2003 and lower purchases of fixed assets of $1.1 million.

Expenditures of capital funds were $12.8 million for the first nine months of fiscal year 2004. Anticipated commitments of capital funds are estimated at $6.7 million for the remainder of fiscal year 2004, mainly for computer hardware purchases, office relocations and renovations, development and upgrade of financial and retirement systems and acquisition-related payments. We expect cash from operations to adequately provide for these cash needs.

Cash Used in Financing Activities

Cash used in financing activities for the first nine months of fiscal year 2004 was $5.5 million, compared to $6.2 million for the first nine months of fiscal year 2003. The decrease was mainly associated with purchases of common stock by associates through the Company s Employee Stock

Purchase Plan and Long-term Incentive Plan, partially offset by repurchases of 510,900 shares of common stock.

Off-Balance Sheet Arrangements and Contractual Obligations

Operating Leases. We lease office space, furniture and selected computer equipment under operating lease agreements with terms ranging from one to ten years. Future expected payments are as follows:

Contractual Cash Obligations	Remaining payments due by fiscal year as of March 31, 2004 Total	2004	2005 through 2006	2007 through 2008	Thereafter
Lease commitments	$ 226,058	$ 9,608	$ 70,088	$ 56,356	$ 90,006

Management has determined that there is not a large concentration of leases that will expire in any one fiscal year. Consequently, management anticipates that any increase in future rent expense will be mainly market driven.

On April 27, 2004, the Company executed a new lease agreement committing its Washington D.C. office, which includes consulting and corporate operations, to move to northern Virginia. The terms of the lease are expected to result in cost savings over the 12 year term. The Company simultaneously provided notice of early termination of its existing Washington D.C. lease which will result in a $3.2 million charge during the fourth quarter of fiscal year 2004. The $3.2 million charge will have no net cash impact on the Company because the Company will receive a $3.2 million payment from the new lessor as an incentive to enter into the new lease.

Guarantees

Wellspring Leases. The Company continues to guarantee certain leases for office premises and equipment for Wellspring. At March 31, 2004, minimum remaining payments guaranteed under these leases, which expire at various dates through 2007, totaled $19.7 million, excluding anticipated sublease income. The leases are currently generating positive cash flows of approximately $0.1 million per fiscal year. In the third quarter of fiscal year 2004, the Company reduced its accrual for the estimated remaining future obligations and costs related to the exit from Wellspring by $1.0 million, less the associated income tax expenses Management will continue to evaluate the adequacy of these provisions and make adjustments as appropriate. See Notes 13 and 15 of the Notes to the Consolidated Financial Statements for more information related to Wellspring.

Affiliate Agreements. In connection with the establishment of our alliance with Watson Wyatt LLP in 1995, the Company agreed to guarantee Watson Wyatt LLP s performance under a lease for office space in London that expires in 2015. Payments by Watson Wyatt LLP under the lease total £1.4 million (or approximately $2.6 million based on the March 31, 2004, exchange rate) per year. We also granted Watson Wyatt LLP an option to return the leased space to our UK subsidiary in 2009. If Watson Wyatt LLP were to exercise this option, the Company would attempt to sublease the space at the then-current market rates.

Credit Agreement

The Company has a $100.0 million revolving credit facility with a syndicate of banks. Interest rates associated with this facility vary with LIBOR and/or the Prime Rate and are based on our leverage ratio, as defined by the credit agreement. We are charged a quarterly commitment fee, currently 0.25 percent of the facility, that varies with our financial leverage and is calculated on the unused portion of the credit facility. No amounts were outstanding under the Company s revolving credit facility as of March 31, 2004, or June 30, 2003. Credit under the facility is available upon demand, although the credit facility requires us to observe certain covenants (including requirements for minimum net worth, which act to restrict dividends and other financial and restrictive covenants) and is collateralized with a pledge of stock of material subsidiaries. We were in compliance with all covenants under the credit facility as of March 31, 2004.

A portion of the revolving facility is used to support required letters of credit issued under the credit line. As a result, $7.5 million of the facility is currently unavailable for operating needs. We are also charged a fee for outstanding letters of credit that fluctuates based on our leverage ratio. The credit facility is scheduled to expire on June 25, 2005.

Risk Management

As a part of our overall risk management program, we carry customary commercial insurance policies, including commercial general liability, employment practices liability, and claims-made professional liability insurance with a self-insured retention of $1 million per claim, which provides coverage for professional liability claims including the cost of defending such claims. Our primary insurance coverage beyond this retention is written by an affiliated captive insurance company owned by us and two other professional services firms. Prior to July 1, 2003, the first $5 million of coverage had a premium structure which provided that the captive insurance company would recover from the firm defending the claim approximately 75 percent of any loss up to $5 million. The Company recorded an accrual for this liability. This recovery occurred through insurance premium payments in subsequent years. The remaining 25 percent of any loss up to $5 million was a risk borne by the captive insurance company, which carried reinsurance in the commercial markets for most losses above $5 million.

As of July 1, 2003, PCIC attempts to recover through its premium structure the amounts it expects to pay out for member companies in claims losses. It bases premium calculations, which are determined annually based on experience through March of each year, on relative risk of the various lines of business performed by each of the owner companies, past claim experience of each owner company, growth of each of those companies, industry risk profiles in general and the overall insurance markets.

Our agreements with PCIC could require additional payments to PCIC in the event that the Company decided to exit PCIC and adverse claims significantly exceed prior expectations. If these circumstances were to occur, the Company would record a liability at the time it becomes estimable and probable.

The Company will continue to provide for the self-insured retention where specific estimated losses for known claims in excess of $1 million are considered probable and reasonably estimable.

Although the Company maintains professional liability insurance coverage, this insurance does not cover claims made after expiration of our current insurance contracts. Generally accepted accounting principles require that we record a liability for incurred but not reported (IBNR) professional liability claims if they are estimable and probable, and for which we have not yet contracted for insurance coverage. The Company uses actuarial assumptions to estimate and record its IBNR liability and has a $13.1 million IBNR liability recorded as of March 31, 2004.

Current insurance market conditions include increases in premium cost, higher self-insured retentions and reductions in aggregate excess coverages, trends that are anticipated to continue. We expect these trends to be reflected in our future annual insurance renewals, and as a result, we will continue to assess our ability to secure future insurance coverage. In anticipation of the possibility of future reductions in risk transfer from PCIC to reinsurers, as well as the trend toward a generally hardening insurance market, the firms that own PCIC, including the Company, increased PCIC s capital in fiscal years 2002 and 2003.

In light of increasing worldwide litigation, including litigation against professionals, the Company has been implementing a requirement that all client relationships be documented by engagement letters containing specific risk mitigation clauses that were not included in all historical client agreements. Nearly 100 percent of the Company s U.S. corporate clients have signed engagement letters including mitigation clauses, and initiatives to complete that process both in the United States and elsewhere are underway. The Company has disengaged from certain client relationships where satisfactory engagement terms could not be achieved.

Recent Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities, which clarifies the financial reporting guidance associated with the consolidation of another entity. Immediate consolidation requirements of FIN 46 were not applicable to the Company since the Company did not create variable interest entities after January 31, 2003. In December 2003, the FASB revised and superceded FIN 46 with the issuance of FIN 46R in order to address certain implementation issues. The Company adopted FIN 46R effective March 31, 2004. See Note 10 regarding the impact of adopting FIN 46R.

Emerging Issues Task Force Issue 00-21, Revenue Arrangements with Multiple Deliverables (EITF 00-21), was effective for the Company beginning July 1, 2003. Beginning July 1, 2003, the Company will apply such requirements prospectively to multiple deliverable arrangements, which include arrangements involving installation and customization of technology solution products sold together with on-going services offered by the Company. Based on the types of arrangements entered into historically, the Company does not expect that adoption of EITF 00-21 will have a material impact on the accounting for such arrangements.

In December 2003, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 104 (SAB 104), Revenue Recognition, which supercedes Staff Accounting Bulletin No. 101 (SAB 101), Revenue Recognition in Financial Statements. SAB 104 s primary purpose is to rescind accounting guidance contained in SAB 101 related to multiple element revenue arrangements, superceded as a result of the issuance of EITF 00-21. While the wording of SAB 104 has changed to reflect the issuance of EITF 00-21, the revenue recognition principles of SAB 101 remain largely unchanged by the issuance of SAB 104. The issuance of SAB 104 has not had an effect on our revenue recognition policies as they are in accordance with SAB 104.

In December 2003, the Financial Accounting Standards Board issued FASB Staff Position (FSP) No. FAS 106-1 Accounting and Disclosure Requirements Related to the Medicare Prescription Drug Improvement and Modernization Act of 2003 (the Act) (FAS 106-1). The Act includes a prescription drug benefit under Medicare Part D as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent (as defined in the Act) to Medicare Part D. In accordance with FAS 106-1, the Company has elected to defer the recognition of the effects of the Act on the consolidated financial statements until pending authoritative guidance on the federal subsidy is issued by the FASB. As a result, measures of the net periodic cost of our post-retirement plans included in the Financial Statements and accompanying Notes do not reflect effects of FAS 106-1 on the plans. The Company does not believe that adoption of FAS 106-1 will have a material effect on the financial condition of the Company.

Disclaimer Regarding Forward-looking Statements

This filing contains certain statements that are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including, but not limited to the following: Note 8 on page 12; Note 12 on page 15; Note 13 on pages 15 and 16 ; Note 14 on page 16; Critical Accounting Policies and Estimates on pages 21 through 24; the Executive Overview on page 25; the discussion of our capital commitments under Cash Used in Investing Activities on page 29; the discussion of expected costs savings under Operating Leases on page 30; and Part II, Item 1 Legal Proceedings on page 34. In some cases, you can identify these statements and other forward-looking statements in this filing by words such as may, will, expect, anticipate, believe, estimate, plan, intend, continue, or similar words. You should read statements carefully because they contain projections of our future results of operations or financial condition, or state other forward-looking information. A number of risks and uncertainties exist which could cause actual results to differ materially from the results reflected in these forward-looking statements. Such factors include, but are not limited to, our

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continued ability to recruit and retain highly qualified associates; outcomes of litigation; a significant decrease in the demand for the consulting services we offer as a result of changing economic conditions or other factors; actions by competitors offering human resources consulting services, including public accounting and consulting firms, technology consulting firms and internet/intranet development firms; regulatory, legislative and technological developments that may affect the demand for or costs of our services; and other factors discussed under risk factors in our Annual Report on Form 10-K for the fiscal year ended June 30, 2003, which was filed with the SEC on September 23, 2003, and may be accessed via EDGAR on the SEC s web site at www.sec.gov. These statements are based on assumptions that may not come true. All forward-looking disclosure is speculative by its nature. The Company undertakes no obligation to update any of the forward-looking information included in this report, whether as a result of new information, future events, changed expectations or otherwise.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risks in the ordinary course of business, although our risk profile has not changed during the period covered by this Form 10-Q. These risks include interest rate risk and foreign currency exchange risk. We have examined our exposure to these risks and have concluded that none of our exposures in these areas is material to fair values, cash flows or earnings.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Chief Executive Officer (CEO) and Chief Financial Officer (CFO) of the Company evaluated our disclosure controls and procedures as of the end of the third quarter of fiscal year 2004. They have concluded that, as of March 31, 2004, such controls and procedures have been effectively designed to ensure that information required to be disclosed in reports that the Company files with or submits to the SEC is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and is accumulated and communicated to management, including the CEO and CFO, as appropriate, to allow timely decisions regarding such disclosure.

Changes in Internal Control Over Financial Reporting

No changes to our internal control over financial reporting have occurred during the third quarter that have come to management s attention that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting.

Compliance with Section 404 of the Sarbanes-Oxley Act of 2002

Our Company is required to comply with Section 404 of the Sarbanes-Oxley Act of 2002 and SEC rules and Public Company Accounting Oversight Board (PCAOB) standards for implementing Section 404 by June 30, 2005. With regards to the Company s continuing compliance efforts, the Company has substantially completed all documentation of financial and company-wide controls. We will begin testing of certain key controls in the fourth quarter in preparation for compliance with Section 404 and plan to continue testing through the first half of fiscal year 2005 in preparation for management s assessment in the second half of fiscal year 2005.

Limitations on the Effectiveness of Controls

Our management, including the CEO and CFO, does not expect that our internal controls will necessarily prevent all error and all fraud. A control system, no matter how well designed and operated, cannot provide absolute assurance that the control system s objectives will be met. In addition, the design of such internal controls must take into account the costs of designing and maintaining such control system. Certain inherent limitations exist in control systems to make absolute assurances difficult, including the realities that judgments in decision-making can be faulty, that breakdowns can occur because of a simple error or mistake, and that individuals can circumvent controls. The design of any control system is based in part upon existing business conditions and risk assessments. There can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in business conditions or deterioration in the degree of compliance with policies or procedures. As a result, they may require change or revision. Because of the inherent limitations in a control system, misstatements due to error or fraud may occur and may not be detected. Nevertheless, management believes that the Company s internal controls over financial reporting for the third quarter of fiscal year 2004 are adequate.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, we are a party to various lawsuits, arbitrations or mediations that arise in the ordinary course of business. These disputes typically involve claims relating to the rendering of professional services or employment matters. Management believes, based on currently available information, that the results of all pending claims against us will not have a material adverse affect on the Company. The matters reported on below involve the most significant pending or potential claims against us. These matters did not significantly impact the quarter s financial results.

New Jersey Coalition of Auto Retailers Insurance Group Trust (NJCAR). The claims have been settled and the suit has been dismissed.

Toussaint, et al. v. James, et al. The claim has been settled and the suit has been dismissed.

Iron Workers Local 25 et al. v. Watson Wyatt & Co. On April 19, 2004, Watson Wyatt & Co. was served with a complaint filed by a former client in the United States District Court for the Eastern District of Michigan. The complaint alleges negligence and negligent supervision in the preparation of an actuarial valuation. The amount of damages sought are not specified.

ITEM 2. CHANGES IN SECURITIES, USE OF PROCEEDS AND ISSUER PURCHASES OF EQUITY SECURITIES

Restricted Shares

In conjunction with our initial public offering in October 2000, we entered into agreements providing for transfer restrictions with major stockholders, executive officers and employee directors. During October 2003, these transfer restrictions expired on 1,908,000 Class A shares. As of March 31, 2004, 1,730,000 Class A shares remain restricted. These shares will become freely transferable in October 2004.

Issuer Purchases of Equity Securities

The table below presents specified information about the Company s stock repurchases and repurchase plans:

Period	Total Number of Shares (or Units) Purchased	Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs (1) (2)
January 1, 2004 through January 31, 2004	97,500	$ 24.47	97,500	928,184
February 1, 2004 through February 29, 2004				928,184
March 1, 2004 through March 31, 2004				4,528,184
Total	97,500	$ 24.47	97,500	

(1) In May 2003, the Company announced a plan to purchase up to 1,150,000 shares of our Class A common stock.

(2) On March 8, 2004, the Company announced the commencement of a tender offer for shares of our Class A common stock, through which we offered to purchase for cash up to 3,600,000 shares, not to exceed $85 million. The tender offer expired on April 2, 2004 and we repurchased 830,802 shares at a purchase price of $25.25, for $21.0 million from selling stockholders.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

a. Exhibits

3.1 Amended and Restated Certificate of Incorporation of Watson Wyatt & Company Holdings(1)

3.2 Amended and Restated Bylaws of Watson Wyatt & Company Holdings(2)

4 Form of Certificate Representing Common Stock(1)

10.1 Amended Credit Agreement Among Bank of America, N.A., and Others dated June 25, 2002(3)

10.2 Credit Agreement Among Bank of America, N.A., and Others dated June 25, 2002(3)

10.3 Consent of Bank of America, N.A. (5)

10.4 Agreement with David B. Friend, M.D., dated October 22, 1999(1)

10.5 Senior Officer Deferred Compensation Plan(5)

10.6 Form of agreement among Watson Wyatt & Company, Watson Wyatt & Company Holdings and employee directors, executive officers and significant stockholders restricting the transfer of shares(4)

10.7 Lease between Watson Wyatt & Company and Arlington Office, L.L.C., dated April 27, 2004(6)

31.1 Certification of Chief Executive Officer Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002(6)

31.2 Certification of Chief Financial Officer Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002(6)

32.1 Certification of Chief Executive Officer Pursuant to Title 18, U.S.C. Section 1350(6)

32.2 Certification of Chief Financial Officer Pursuant to Title 18, U.S.C. Section 1350(6)

b. Reports on Form 8-K

(i) On February 5, 2004, the Company filed a Current Report on Form 8-K, which included a press release dated the same day, in which we reported our second quarter fiscal year 2004 earnings.

(ii) On May 6, 2004, the Company filed a Current Report on Form 8-K, which included a press release dated the same day, in which we reported our third quarter fiscal year 2004 earnings.

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(1) Incorporated by reference from Registrant s Form S-3/A, Amendment No. 1 (File No. 33-394973), filed on

March 17, 2000

(2) Incorporated by reference from Registrant s Form 10-Q, filed on May 2, 2001

(3) Incorporated by reference from Registrant s Form 10-K, filed on September 25, 2002

(4) Incorporated by reference from Registrant s Form S-3/A, Amendment No. 5 (File No. 33-394973), filed on September 14, 2000

(5) Incorporated by reference from Registrant s Form 10-K, filed on August 15, 2001

(6) Filed with this Form 10-Q

Signatures

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Watson Wyatt & Company Holdings
(Registrant)

/S/ John J. Haley		May 7, 2004
Name:	John J. Haley	Date
Title:	President and Chief Executive Officer	
/S/ Carl D. Mautz		May 7, 2004
Name:	Carl D. Mautz	Date
Title:	Vice President and Chief Financial Officer	
/S/ Peter L. Childs		May 7, 2004
Name:	Peter L. Childs	Date
Title:	Controller	