FTI CONSULTING INC
Form 10-Q
August 02, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2012

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission file number 001-14875

FTI CONSULTING, INC.

(Exact Name of Registrant as Specified in its Charter)

Maryland	**52-1261113**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
777 South Flagler Drive, Suite 1500 West Tower, West Palm Beach, Florida	**33401**
(Address of Principal Executive Offices)	**(Zip Code)**

(561) 515-1900

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web Site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files. Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer , accelerated filer , and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

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

Class	**Outstanding at July 25, 2012**
Common stock, par value $0.01 per share	42,050,496

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FTI CONSULTING, INC. AND SUBSIDIARIES

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PART I FINANCIAL INFORMATION

FTI Consulting, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(in thousands, except per share amounts)

Item 1. Financial Statements

	June 30, 2012 (Unaudited)	December 31, 2011
Assets		
Current assets		
Cash and cash equivalents	$ 165,981	$ 264,423
Restricted cash	1,152	10,213
Accounts receivable:		
Billed receivables	355,598	335,758
Unbilled receivables	200,361	173,440
Allowance for doubtful accounts and unbilled services	(83,300)	(80,096)
Accounts receivable, net	472,659	429,102
Current portion of notes receivable	33,454	26,687
Prepaid expenses and other current assets	35,400	30,448
Income taxes receivable	15,790	10,081
Total current assets	724,436	770,954
Property and equipment, net of accumulated depreciation	68,807	74,448
Goodwill	1,313,382	1,309,358
Other intangible assets, net of amortization	107,782	118,889
Notes receivable, net of current portion	99,191	81,748
Other assets	60,483	55,687
Total assets	$ 2,374,081	$ 2,411,084
Liabilities and Stockholders Equity		
Current liabilities		
Accounts payable, accrued expenses and other	$ 96,421	$ 132,773
Accrued compensation	137,378	180,366
Current portion of long-term debt and capital lease obligations	154,305	153,381
Billings in excess of services provided	19,958	19,063
Deferred income taxes	7,375	12,254
Total current liabilities	415,437	497,837
Long-term debt and capital lease obligations, net of current portion	643,078	643,579
Deferred income taxes	94,376	88,071
Other liabilities	70,867	75,395
Total liabilities	1,223,758	1,304,882

Commitments and contingent liabilities (notes 7, 9 and 10)

Stockholders equity		
Preferred stock, $0.01 par value; shares authorized 5,000; none outstanding		
Common stock, $0.01 par value; shares authorized 75,000; shares issued and outstanding 42,039 (2012) and 41,484 (2011)	420	415
Additional paid-in capital	400,027	383,978
Retained earnings	804,379	778,201
Accumulated other comprehensive loss	(54,503)	(56,392)
Total stockholders equity	1,150,323	1,106,202
Total liabilities and stockholders equity	$ 2,374,081	$ 2,411,084

See accompanying notes to the condensed consolidated financial statements

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FTI Consulting, Inc. and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income (Loss)

(in thousands, except per share data)

Unaudited

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Revenues	$ 396,243	$ 400,437	$ 791,471	$ 762,253
Operating expenses				
Direct cost of revenues	248,220	250,844	493,838	473,928
Selling, general and administrative expense	92,460	94,442	195,049	182,745
Special charges	26,782	15,212	26,782	15,212
Acquisition-related contingent consideration	(3,541)	799	(2,984)	1,595
Amortization of other intangible assets	5,490	5,498	11,007	10,952
	369,411	366,795	723,692	684,432
Operating income	26,832	33,642	67,779	77,821
Other income (expense)				
Interest income and other	(363)	2,923	2,919	4,923
Interest expense	(15,195)	(14,500)	(30,399)	(29,810)
	(15,558)	(11,577)	(27,480)	(24,887)
Income before income tax provision	11,274	22,065	40,299	52,934
Income tax provision	3,527	6,740	14,121	18,351
Net income	$ 7,747	$ 15,325	$ 26,178	$ 34,583
Earnings per common share basic	$ 0.19	$ 0.38	$ 0.65	$ 0.82
Earnings per common share diluted	$ 0.18	$ 0.36	$ 0.61	$ 0.78
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments, net of tax expense (benefit) of $0 for the three and six months ended June 30, 2012, and $100 and ($2,068) for the three and six months ended June 30, 2011, respectively	$ (10,960)	$ 1,836	$ 1,889	$ 16,655
Other comprehensive income (loss), net of tax	(10,960)	1,836	1,889	16,655
Comprehensive income (loss)	$ (3,213)	$ 17,161	$ 28,067	$ 51,238

See accompanying notes to the condensed consolidated financial statements

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FTI Consulting, Inc. and Subsidiaries

Condensed Consolidated Statement of Stockholders Equity

(in thousands)

Unaudited

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
	Shares	Amount				
Balance December 31, 2011	41,484	$ 415	$ 383,978	$ 778,201	$ (56,392)	$ 1,106,202
Net income				26,178		26,178
Other comprehensive income:						
Cumulative translation adjustment					1,889	1,889
Issuance of common stock in connection with:						
Exercise of options, net of income tax expense from share-based awards of $218	137	1	3,496			3,497
Restricted share grants, less net settled shares of 117	418	4	(4,576)			(4,572)
Stock units issued under incentive compensation plan			3,079			3,079
Business combinations			(3,647)			(3,647)
Reacquisition of equity component of convertible debt			(108)			(108)
Share-based compensation			17,805			17,805
Balance June 30, 2012	42,039	$ 420	$ 400,027	$ 804,379	$ (54,503)	$ 1,150,323

See accompanying notes to the condensed consolidated financial statements

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FTI Consulting, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(in thousands)

Unaudited

	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Operating activities		
Net income	$ 26,178	$ 34,583
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	18,449	14,088
Amortization of other intangible assets	11,186	10,952
Acquisition-related contingent consideration	(2,984)	1,595
Provision for doubtful accounts	7,027	5,768
Non-cash share-based compensation	17,805	22,283
Excess tax benefits from share-based compensation	(71)	(124)
Non-cash interest expense	3,887	4,190
Other	141	136
Changes in operating assets and liabilities, net of effects from acquisitions:		
Accounts receivable, billed and unbilled	(50,190)	(99,137)
Notes receivable	(23,834)	(4,638)
Prepaid expenses and other assets	(4,363)	(5,893)
Accounts payable, accrued expenses and other	(1,216)	227
Income taxes	(17,108)	(8,599)
Accrued compensation	(43,081)	4,093
Billings in excess of services provided	886	7,652
Net cash used in operating activities	(57,288)	(12,824)
Investing activities		
Payments for acquisition of businesses, net of cash received	(21,550)	(50,888)
Purchases of property and equipment	(13,728)	(12,705)
Other	93	(405)
Net cash used in investing activities	(35,185)	(63,998)
Financing activities		
Borrowings under revolving line of credit		25,000
Payments of revolving line of credit		(25,000)
Payments of long-term debt and capital lease obligations	(1,974)	(937)
Purchase and retirement of common stock		(209,400)
Net issuance of common stock under equity compensation plans	(840)	685
Excess tax benefits from share-based compensation	71	124
Other	(1,395)	51
Net cash used in financing activities	(4,138)	(209,477)
Effect of exchange rate changes on cash and cash equivalents	(1,831)	474
Net decrease in cash and cash equivalents	(98,442)	(285,825)

Cash and cash equivalents, beginning of period	264,423	384,570
Cash and cash equivalents, end of period	$ 165,981	$ 98,745
Supplemental cash flow disclosures		
Cash paid for interest	$ 25,367	$ 25,711
Cash paid for income taxes, net of refunds	31,230	27,016
Non-cash investing and financing activities:		
Issuance of stock units under incentive compensation plans	3,079	4,241

See accompanying notes to the condensed consolidated financial statements

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FTI Consulting, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

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

Unaudited

1. Basis of Presentation and Significant Accounting Policies

The unaudited condensed consolidated financial statements of FTI Consulting, Inc. and its wholly owned subsidiaries (FTI Consulting, the Company, we, or our) presented herein have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) and under the rules and regulations of the Securities and Exchange Commission (SEC) for interim financial information. Some of the information and footnote disclosures normally included in annual financial statements have been condensed or omitted pursuant to those rules and regulations. In management s opinion, the interim financial statements reflect all adjustments that are necessary for a fair presentation of the results for the interim periods presented. All adjustments made were normal recurring accruals. Results of operations for the interim periods presented herein are not necessarily indicative of results of operations for a full year. These financial statements should be read in conjunction with the consolidated financial statements and the notes contained in our Annual Report on Form 10-K for the year ended December 31, 2011.

2. Earnings Per Common Share

Basic earnings per common share are calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per common share adjust basic earnings per share for the effects of potentially dilutive common shares. Potentially dilutive common shares include the dilutive effects of shares issuable under our equity compensation plans, including stock options and restricted stock, and shares issuable upon conversion of our 3 $^{3}/_{4}$% senior subordinated convertible notes due 2012 (Convertible Notes) assuming the conversion premium was converted into common stock based on the average closing price per share of our stock during the period, each using the treasury stock method. The conversion feature of our Convertible Notes had a dilutive effect on our earnings per share for the periods presented below because the average closing price per share of our common stock for such periods was above the conversion price of the Convertible Notes of $31.25 per share.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	**2011**	**2012**	**2011**
Numerator basic and diluted				
Net income	$ 7,747	$ 15,325	$ 26,178	$ 34,583
Denominator				
Weighted average number of common shares outstanding basic	40,592	40,587	40,475	42,223
Effect of dilutive stock options	646	949	804	918
Effect of dilutive convertible notes	229	836	737	759
Effect of dilutive restricted shares	607	540	656	520
Weighted average number of common shares outstanding diluted	42,074	42,912	42,672	44,420
Earnings per common share basic	$ 0.19	$ 0.38	$ 0.65	$ 0.82
Earnings per common share diluted	$ 0.18	$ 0.36	$ 0.61	$ 0.78
Antidilutive stock options and restricted shares	3,530	2,162	2,806	2,091

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3. Special Charges

During the second quarter of 2011, we recorded special charges of $15.2 million. The charges reflect actions we took to reduce senior management related overhead in connection with the realignment of our segment management on a global basis and to align our workforce with expected market trends, primarily in our Corporate Finance/Restructuring segment.

During the quarter ended June 30, 2012, we recorded special charges totaling $26.8 million, of which $4.6 million was non-cash. The charges reflect actions we took to realign our workforce to address current business demands and global macro-economic conditions impacting our Forensic and Litigation Consulting, Strategic Communications and Technology segments and address certain targeted practices within our Corporate Finance/Restructuring and Economic Consulting segments, and to reduce excess real estate capacity. These actions include the termination of 116 employees, the consolidation of leased office space within six office locations and certain other actions. The special charges consisted of:

- $18.4 million of salary continuance and other contractual employee related costs, including loan forgiveness and accelerated recognition of compensation cost of share-based awards, associated with the reduction in workforce of 116 employees; and

- $8.4 million of expense associated with lease costs related to the consolidation of leased office space within six office locations.

The following table details the special charges by segment for the quarter ended June 30, 2012:

Corporate Finance/Restructuring	$ 11,116
Forensic and Litigation Consulting	7,253
Economic Consulting	818
Technology	2,966
Strategic Communications	4,511
	26,664
Unallocated Corporate	118
Total	$ 26,782

The total cash outflow associated with the 2012 special charges is expected to be $22.2 million, of which $1.1 million has been paid as of June 30, 2012, $9.4 million is expected to be paid during the remainder of 2012, $5.1 million is expected to be paid in 2013, $2.4 million is expected to be paid in 2014, and the remaining balance of $4.2 million related to lease costs will be paid from 2015 to 2025. In addition, the remaining balance of $0.9 million related to the 2011 special charges is expected to be paid during the remainder of 2012. A liability for the current and noncurrent portions of the amounts to be paid is included in Accounts payable, accrued expenses and other and Other liabilities, respectively, on the Condensed Consolidated Balance Sheets. Activity related to the liability for these costs for the six months ended June 30, 2012 is as follows:

	Employee Termination Costs	Lease Costs	Total
Balance at December 31, 2011	$ 4,758	$	$ 4,758
Additions	14,086	8,067	22,153
Payments	(4,372)	(171)	(4,543)
Foreign currency translation adjustment and other	(266)		(266)
Balance at June 30, 2012	$ 14,206	$ 7,896	$ 22,102

4. Provision for Doubtful Accounts

The provision for doubtful accounts is recorded after the related work has been billed to the client and we determine that full collectability is not reasonably assured. It is classified in Selling, general and administrative expense on the Condensed Consolidated Statements of Comprehensive Income (Loss). The provision for doubtful accounts totaled $2.5 million and $7.0 million for the three and six months ended June 30, 2012, respectively and $3.2 million and $5.8 million for the three and six months ended June 30, 2011, respectively.

5. Research and Development Costs

Research and development costs related to software development totaled $5.1 million and $11.9 million for the three and six months ended June 30, 2012, respectively, and $6.0 million and $11.8 million for the three and six months ended June 30, 2011, respectively. Research and development costs are included in Selling, general and administrative expense on the Condensed Consolidated Statements of Comprehensive Income (Loss).

6. Financial Instruments

Derivative Financial Instruments

From time to time, we hedge the cash flows and fair values of some of our long-term debt using interest rate swaps. We enter into these derivative contracts to manage our exposure to interest rate changes by achieving a desired proportion of fixed rate versus variable rate debt.

Accordingly, to achieve the desired mix of fixed and floating interest rate debt, we entered into four interest rate swap agreements in March 2011, which we designated as fair value hedges of our 7 $^{3}/_{4}$% senior notes due 2016 (2016 Notes). Under the terms of the interest rate swaps, we received interest on the $215.0 million notional amount at a fixed rate of 7 $^{3}/_{4}$% and paid a variable rate of interest, which varied between 5.43% and 5.56% for the year ended December 31, 2011. The variable rate was based on the London Interbank Offered Rate (LIBOR) as the benchmark interest rate. The maturity, payment dates and other critical terms of these swaps exactly matched those of the hedged 2016 Notes. These interest rate swaps qualified for hedge accounting using the short-cut method under ASC 815-20-25, *Derivatives and Hedging,* which assumes no hedge ineffectiveness. As a result, the changes in the fair value of the interest rate swaps and the changes in fair value of the hedged debt were assumed to be equal and offsetting.

On December 16, 2011, we negotiated the right to terminate the interest rate swap agreements. Upon termination of these interest rate swap agreements we received cash proceeds of approximately $6.6 million, including $1.0 million of accrued interest. The net proceeds of $5.6 million have been recorded in Long-term debt and capital lease obligations on the Condensed Consolidated Balance Sheets and will be amortized as a reduction to interest expense over the remaining term of the 2016 Notes, resulting in an effective interest rate of 7.1% per annum. For the six months ended June 30, 2012, $0.5 million of the net proceeds have been amortized as a reduction of interest expense, with a remaining balance of $5.1 million at June 30, 2012. At June 30, 2012, we had no derivative instruments.

Fair Value of Financial Instruments

We consider the recorded value of certain of our financial assets and liabilities, which consist primarily of cash equivalents, accounts receivable and accounts payable, to approximate the fair value of the respective assets and liabilities at June 30, 2012 and December 31, 2011, based on the short-term nature of the assets and liabilities. The fair value of our long-term debt at June 30, 2012 was $825 million compared to a carrying value of $815 million. At December 31, 2011, the fair value of our long-term debt was $882 million compared to a carrying value of $815 million. We determine the fair value of our long-term debt primarily based on quoted market prices for our 2016 Notes, 6 $^{3}/_{4}$% senior notes due 2020 and Convertible Notes. The fair value of our long-term debt is classified within Level 2 of the fair value hierarchy, because it is traded in less active markets. The carrying value of long-term debt includes the $18.0 million equity component of our Convertible Notes which is recorded in Additional paid-in capital on the Condensed Consolidated Balance Sheets.

We estimate the fair value of acquisition-related contingent consideration using a probability-weighted discounted cash flow model. This fair value measure is based on significant inputs not observed in the market and thus represents a Level 3 measurement. Fair value measurements characterized within Level 3 of the fair value hierarchy are valued based on unobservable inputs that are supported by little or no market activity and reflect our own assumptions in measuring fair value.

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The significant unobservable inputs used in the fair value measurements of our acquisition-related contingent consideration are our measures of the future profitability and related cash flows and discount rates. Significant increases (decreases) in any of these inputs in isolation would result in a significantly lower (higher) fair value measurement. Generally, a change in the assumptions used for the discount rates is accompanied by a directionally opposite change in the fair value measurement and a change in the assumptions used for the future cash flows is accompanied by a directionally similar change in the fair value measurement.

The following table represents the change in the acquisition-related contingent consideration liability during the three and six months ended June 30, 2012 and 2011:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands)	**2012**	**2011**	**2012**	**2011**
Beginning balance	$ 15,276	$ 20,076	$ 14,990	$ 19,864
Acquisition date fair value measurement		3,000		3,000
Adjustments to fair value recorded in earnings[(a)]	(3,541)	799	(2,984)	1,595
Payments	(917)		(1,287)	(577)
Elimination of contingency[(b)]	(2,534)		(2,534)	
Unrealized gains (losses) related to currency translation in other comprehensive income	(47)	7	52	
Ending balance	$ 8,237	$ 23,882	$ 8,237	$ 23,882