

FIRST SOLAR, INC.
Form 10-Q
August 02, 2010

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

Form 10-Q

(Mark one)

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

For the quarterly period ended June 26, 2010

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: 001-33156

First Solar, Inc.

(Exact name of registrant as specified in its charter)

Delaware	20-4623678
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

350 West Washington Street, Suite 600
Tempe, Arizona 85281
(Address of principal executive offices, including zip code)

(602) 414-9300
(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 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

As of July 23, 2010 there were 85,554,984 shares of the registrant's common stock, par value \$0.001, outstanding.

FIRST SOLAR, INC. AND SUBSIDIARIES

FORM 10-Q FOR THE QUARTERLY PERIOD ENDED JUNE 26, 2010

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PART I. FINANCIAL INFORMATION

Item 1. Unaudited Condensed Consolidated Financial Statements

FIRST SOLAR, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 26, 2010	June 27, 2009	June 26, 2010	June 27, 2009
Net sales	\$ 587,854	\$ 525,876	\$ 1,155,815	\$ 944,084
Cost of sales	303,660	227,780	589,585	410,704
Gross profit	284,194	298,096	566,230	533,380
Operating expenses:				
Research and development	22,836	18,605	45,724	30,309
Selling, general and administrative	78,597	72,926	145,461	122,241
Production start-up	2,288	2,524	3,431	8,733
Total operating expenses	103,721	94,055	194,616	161,283
Operating income	180,473	204,041	371,614	372,097
Foreign currency (loss) gain	(2,625)	239	(3,321)	2,073
Interest income	3,035	1,948	8,683	4,051
Interest expense, net	(6)	(3,827)	(6)	(4,762)
Other expense, net	(439)	(1,103)	(1,173)	(2,429)
Income before income taxes	180,438	201,298	375,797	371,030
Income tax expense	21,395	20,719	44,409	25,856
Net income	\$ 159,043	\$ 180,579	\$ 331,388	\$ 345,174
Net income per share:				
Basic	\$ 1.87	\$ 2.16	\$ 3.91	\$ 4.17
Diluted	\$ 1.84	\$ 2.11	\$ 3.84	\$ 4.10
Weighted-average number of shares used in per share calculations:				
Basic	84,852	83,723	84,679	82,704
Diluted	86,401	85,668	86,247	84,140

See accompanying notes to these condensed consolidated financial statements.

FIRST SOLAR, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

(Unaudited)

	June 26, 2010		December 26, 2009
ASSETS			
Current assets:			
Cash and cash equivalents	\$ 510,482		\$ 664,499
Marketable securities and investments	285,993		120,236
Accounts receivable trade, net	256,344		226,826
Accounts receivable, unbilled	105,333		58
Inventories	194,308		152,821
Project assets	109		1,081
Deferred tax asset, net	19,248		21,679
Prepaid expenses and other current assets	244,053		164,071
Total current assets	1,615,870		1,351,271
Property, plant and equipment, net	1,094,877		988,782
Project assets	140,065		131,415
Deferred tax asset, net	157,778		130,515
Marketable securities	164,017		329,608
Restricted cash and investments	81,103		36,494
Investment in related party	25,000	segments is evaluated on operating income excluding the costs of infrastructure and shared service costs (such as facilities, information systems, finance and accounting, human resources, legal and marketing), which is represented by the Corporate/Other segment.	

	Three Months Ended September 30,			
	2007		2006	
	Operating		Operating	
	Income		Income	
	Revenue	(Loss)	Revenue	(Loss)
Public Services	\$ 362,893	\$ 64,593	\$ 333,825	\$ 61,565
Commercial Services	131,383	21,135	133,253	20,572

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Financial				
Services	66,412	8,207	97,161	26,184
EMEA	184,318	24,132	167,089	28,420
Asia Pacific	94,081	20,575	91,609	20,841
Latin America	22,240	(3,338)	18,758	(125)
Corporate/Other	570	(163,008)	1,553	(172,326)

Total \$ 861,897 \$ (27,704) \$ 843,248 \$ (14,869)

Nine Months Ended September 30,

	2007		2006	
	Operating		Operating	
	Revenue	(Loss)	Revenue	(Loss)
Public Services	\$ 1,084,080	\$ 197,335	\$ 1,006,022	\$ 184,370
Commerical				
Services	401,638	61,149	409,683	32,433
Financial				
Services	209,378	18,641	319,833	95,919
EMEA	570,111	92,852	501,696	80,754
Asia Pacific	267,161	51,877	271,671	57,054
Latin America	67,787	(8,614)	56,639	1,984
Corporate/Other	3,340	(518,304)	4,128	(543,675)
Total	\$ 2,603,495	\$ (105,064)	\$ 2,569,672	\$ (91,161)

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (continued)
(in thousands, except share and per share amounts)
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Note 7. Goodwill

The changes in the carrying amount of goodwill, at the reporting unit level, for the nine months ended September 30, 2007 were as follows:

	Balance December 31, 2006	Reductions	Foreign Currency Translation Adjustment	Balance September 30, 2007
Public Services	\$ 23,581	\$	\$	\$ 23,581
Financial Services	9,210			9,210
EMEA	359,133	(7,495)(1)	26,402	378,040
Asia Pacific	70,402		4,489	74,891
Latin America	918		72	990
Corporate/Other	202			202
Total	\$ 463,446	\$ (7,495)	\$ 30,963	\$ 486,914

(1) Amount represents the reversal of uncertain income tax liabilities recorded as part of the acquisition of a consulting practice in EMEA against goodwill, whereas the statute of limitations for the potential tax liability expired during the first quarter of 2007.

In April 2007, the Company completed its required annual impairment test and determined that the carrying value of goodwill was not impaired.

Note 8. Lease and Facilities Restructuring Activities

During the three and nine months ended September 30, 2007, the Company recorded restructuring charges of \$3,866 and \$308, respectively, both in connection with the Company's previously announced office space reduction efforts. Restructuring charges for the nine months were significantly offset by a credit recorded in the first quarter of

2007 which accounted for a net reduction of accruals, primarily attributable to the change in sublease income assumptions associated with vacated leased facilities. During the three and nine months ended September 30, 2006, the Company recorded restructuring charges of \$961 and \$6,249, respectively, both in connection with the Company's previously announced office space reduction efforts.

Since July 2003, the Company has incurred a total of \$132,645 in lease and facilities-related restructuring charges in connection with its office space reduction effort relating to the following regions: \$25,457 in EMEA, \$863 in Asia Pacific and \$106,325 in North America. As of September 30, 2007, the Company had a remaining lease and facilities accrual of \$54,783, of which \$14,167 and \$40,616 have been identified as current and non-current portions, respectively. The remaining lease and facilities accrual will be paid over the remaining lease terms which expire at various dates through 2014.

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Changes in the Company's accrual for restructuring charges for the nine months ended September 30, 2007 were as follows:

	Total
Balance at December 31, 2006	\$ 66,918
Adjustment to the provision, net	308
Utilization	(13,757)
Other (1)	1,314
 Balance at September 30, 2007	 \$ 54,783

- (1) Other changes in the restructuring accrual consist primarily of foreign currency translation adjustments.

Note 9. Commitments and Contingencies

The Company currently is a party to a number of disputes which involve or may involve litigation or other legal or regulatory proceedings. Generally, there are three types of legal proceedings to which the Company has been made a party:

Claims and investigations arising from its continuing inability to timely file periodic reports under the Exchange Act (the Exchange Act), and the restatement of its financial statements for certain prior periods to correct accounting errors and departures from generally accepted accounting principles for those years (SEC Reporting Matters);

Claims and investigations being conducted by agencies or officers of the U.S. Federal government and arising in connection with its provision of services under contracts with agencies of the U.S. Federal government (Government Contracting Matters); and

Claims made in the ordinary course of business by clients seeking damages for alleged breaches of contract or failure of performance, by current or former employees seeking damages for alleged acts of wrongful termination or discrimination, and by creditors or other vendors alleging defaults in payment or performance (Other Matters).

The Company currently maintains insurance in types and amounts customary in its industry, including coverage for professional liability, general liability and management and director liability. Based on management's current assessment and insurance coverages believed to be available, the Company believes that its financial statements include adequate provision for estimated losses that are likely to be incurred with regard to all matters of the types described above.

SEC Reporting Matters

2005 Class Action Suits

In and after April 2005, various separate complaints were filed in the U.S. District Court for the Eastern District of Virginia alleging that the Company and certain of its current and former officers and directors violated Section 10(b) of the Exchange Act, Rule 10b-5 promulgated thereunder and Section 20(a) of the Exchange Act by, among other things, making materially misleading statements between August 14, 2003 and April 20, 2005 with respect to its financial results in the Company's SEC periodic filings and press releases. On January 17, 2006, the court certified a class, appointed class counsel and appointed a class representative. The plaintiffs filed an amended complaint on March 10, 2006 and the defendants, including the Company, subsequently filed a motion to dismiss that complaint, which was fully briefed and heard on May 5, 2006. The Company was awaiting a ruling when, on March 23, 2007, the court stayed the case, pending the U.S. Supreme Court's decision in the case of *Makor Issues & Rights, Ltd v. Tellabs*, argued before the Supreme Court on March 28, 2007. On June 21, 2007, the Supreme Court issued its opinion in the *Tellabs* case,

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holding that to plead a strong inference of a defendant's fraudulent intent under the applicable federal securities laws, a plaintiff must demonstrate that such an inference is not merely reasonable, but cogent and at least as compelling as any opposing inference of non-fraudulent intent. The court ordered both parties to submit briefs regarding the impact of *Tellabs* upon the defendant's motion to dismiss. The parties filed their briefs on July 16, 2007, and oral arguments were held on July 27, 2007. On September 12, 2007, the court dismissed with prejudice this complaint, granting motions to dismiss filed by the Company and the other named defendants. In granting the Company's motion to dismiss, the court ruled that the plaintiff failed to meet the scienter pleading requirements set forth in the Private Securities Litigation Reform Act of 1995, as amended. On September 26, 2007, the plaintiffs filed a motion that seeks a reversal of the court's order dismissing the case or an amendment to the court's order that would allow the plaintiffs to replead. The Company filed its brief on October 17, 2007 and although a hearing on the plaintiffs' motion was scheduled for November 16, 2007, the court canceled the hearing as not necessary. On November 19, 2007, the court issued an order denying the plaintiffs' motion to amend or alter the court's September 12, 2007 dismissal of this matter.

2005 Shareholders' Derivative Demand

On May 21, 2005, the Company received a letter from counsel representing one of its shareholders requesting that the Company initiate a lawsuit against its Board of Directors and certain present and former officers of the Company, alleging breaches of the officers' and directors' duties of care and loyalty to the Company relating to the events disclosed in its report filed on Form 8-K, dated April 20, 2005. On January 21, 2006, the shareholder filed a derivative complaint in the Circuit Court of Fairfax County, Virginia, that was not served on the Company until March 2006. The shareholder's complaint alleged that his demand was not acted upon and alleged the breach of fiduciary duty claims previously stated in his demand. The complaint also included a non-derivative claim seeking the scheduling of an annual meeting in 2006. On May 18, 2006, following an extensive audit committee investigation, the Company's Board of Directors responded to the shareholder's demand by declining at that time to file a suit alleging the claims asserted in the shareholder's demand. The shareholder did not amend the complaint to reflect the refusal of his demand. The Company filed demurrers on August 11, 2006, which effectively sought to dismiss the matter related to the fiduciary duty claims. On November 3, 2006, the court granted the demurrers and dismissed the fiduciary claims, with leave to file amended claims. As a result of the Company's annual meeting of stockholders held on December 14, 2006, the claim seeking the scheduling of an annual meeting became moot. On January 3, 2007, the plaintiff filed an amended derivative complaint re-asserting the previously dismissed derivative claims and alleging that the Board's refusal of his demand was not in good faith. The Company's renewed motion to dismiss all remaining claims was heard on March 23, 2007 and no ruling has yet been entered. The Company has a reasonable possibility of loss in this matter, although no estimate of such loss can be determined at this time. Accordingly, no liability has been recorded.

SEC Investigation

On April 13, 2005, pursuant to the same matter number as its inquiry concerning the Company's restatement of certain financial statements issued in 2003, the staff of the SEC's Division of Enforcement requested information and documents relating to the Company's March 18, 2005 Form 8-K. On September 7, 2005, the Company announced that the staff had issued a formal order of investigation in this matter. The Company subsequently has received subpoenas from the staff seeking production of documents and information including certain information and documents related to an investigation conducted by its Audit Committee. The Company continues to provide information and documents to the SEC as requested. The investigation is ongoing and the SEC is in the process of taking the testimony of a number of the Company's current and former employees, as well as a former director.

In connection with the investigation by its Audit Committee, the Company became aware of incidents of possible non-compliance with the Foreign Corrupt Practices Act and its internal controls in connection with certain of its operations in China and voluntarily reported these matters to the SEC and U.S. Department of Justice in November 2005. Both the SEC and the Department of Justice are investigating these matters in connection with the formal investigation described above. On March 27, 2006, the Company received a subpoena from the SEC regarding

information related to these matters. The Company has a reasonable possibility of loss in this matter, although no estimate of such loss can be determined at this time. Accordingly, no liability has been recorded.

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(in thousands, except share and per share amounts)
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Government Contracting Matters

A significant portion of the Company's business relates to providing services under contracts with the U.S. Federal government or state and local governments, inclusive of government sponsored enterprises. These contracts are subject to extensive legal and regulatory requirements and, from time to time, agencies of the U.S. Federal government or state and local governments investigate whether the Company's operations are being conducted in accordance with these requirements and the terms of the relevant contracts. In the ordinary course of business, various government investigations are ongoing. U.S. Federal government investigations of the Company, whether relating to these contracts or conducted for other reasons, could result in administrative, civil or criminal liabilities, including repayments, fines or penalties being imposed upon the Company, or could lead to suspension or debarment from future U.S. Federal government contracting. The Company believes that it has adequately reserved for any losses it may experience from these investigations. Whether such amounts could have a material effect on the results of operations in a particular quarter or fiscal year cannot be determined at this time.

Other Matters*Michael Donahue*

In March 2005, Mr. Donahue filed suit against the Company in connection with the termination of his employment in February 2005. Mr. Donahue alleges he is owed \$3,000 under the terms and conditions of a Special Termination Agreement he executed in November 2001, between \$1,700 and \$2,400 as compensation for the value of stock options he was required to forfeit as the result of his discharge, and an additional \$200 for an unpaid bonus. Mr. Donahue has also argued that a 25% penalty pursuant to Pennsylvania law should be added to each of these sums. In May 2005, the Company removed the matter to Federal Court. On October 5, 2005, Mr. Donahue filed his Complaint in Federal Court, under seal. In this Complaint, in response to the Company's motion to compel arbitration, Mr. Donahue dropped his claims for his stock options and performance bonus, although he is free to bring those claims again at a later time. On January 31, 2006, Mr. Donahue filed his Demand for Arbitration, asserting all the claims he originally asserted, including his claims under the Special Termination Agreement, his claims for his stock options, and his claim for his annual bonus payment for 2004, in addition to the statutory penalties sought for these unpaid amounts. The parties have selected arbitrators for the panel, and discovery has commenced. The arbitration hearing has been set to begin on January 1, 2008. Due to the early stage of this matter, the nature of the potential claims and differing interpretations of Mr. Donahue's Special Termination Agreement, the Company is unable to estimate the amount of potential loss at this time. Accordingly, no liability has been recorded.

Softline Acquisition Obligation

On May 27, 1999, KPMG LLP (the Company's former parent) acquired all of the voting common stock of Softline Consulting & Integrators, Inc. (Softline), a systems integration company, and entered into an agreement with the then shareholders of Softline (the Softline Sellers) to acquire all of the Softline nonvoting common stock for not less than \$65,000. In August 2000, the Company and the Softline Sellers entered into an amendment pursuant to which the Company acquired the nonvoting common stock of Softline and paid \$65,000 to the Softline Sellers. Of the \$65,000 purchase price, the parties agreed to hold back \$15,000, which accrued interest at 6% per annum (the Softline Holdback), until the final determination of claims by the Company against the Softline Sellers. The Softline Holdback was payable in shares of the Company's common stock (calculated based on the Company's initial public offering price less the underwriting discount in such offering); provided, however, that the Softline Sellers could elect to receive cash in lieu of up to 30% of the shares of the Company common stock otherwise issuable to such Softline Sellers. The amount of cash to be paid would be calculated based on average closing price for the Company's common stock during the 20 trading days immediately preceding the date such notice of election was provided to the Company.

The Softline Sellers elected to settle the Softline Holdback by a payment of an aggregate of \$2,025 in cash and the issuance of an aggregate of 563,474 shares of the Company's common stock, which payment and issuance was made on August 16, 2007.

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(in thousands, except share and per share amounts)
(unaudited)

Other Commitments

In the normal course of business, the Company has indemnified third parties and has commitments and guarantees under which it may be required to make payments in certain circumstances. The Company accounts for these indemnities, commitments and guarantees in accordance with FASB Interpretation No. (FIN) 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. These indemnities, commitments and guarantees include: indemnities to third parties in connection with surety bonds; indemnities to various lessors in connection with facility leases; indemnities to customers related to intellectual property and performance of services subcontracted to other providers; and indemnities to directors and officers under the organizational documents and agreements of the Company. The duration of these indemnities, commitments and guarantees varies, and in certain cases, is indefinite. Certain of these indemnities, commitments and guarantees do not provide for any limitation of the maximum potential future payments the Company could be obligated to make. The Company estimates that the fair value of these agreements was immaterial. Accordingly, no liabilities have been recorded for these agreements as of September 30, 2007.

Some clients, largely in the state and local market, require the Company to obtain surety bonds, letters of credit or bank guarantees for client engagements. As of September 30, 2007, the Company had \$83,053 of outstanding surety bonds and \$92,224 of outstanding letters of credit for which the Company may be required to make future payment. See Note 3, Notes Payable for additional information.

From time to time, the Company enters into contracts with clients whereby it has joint and several liability with other participants and/or third parties providing related services and products to clients. Under these arrangements, the Company and other parties may assume some responsibility to the client or a third party for the performance of others under the terms and conditions of the contract with or for the benefit of the client or in relation to the performance of certain contractual obligations. In some arrangements, the extent of the Company s obligations for the performance of others is not expressly specified. Certain of these guarantees do not provide for any limitation of the maximum potential future payments the Company could be obligated to make. As of September 30, 2007, the Company estimates it had assumed an aggregate potential contract value of approximately \$44,385 to its clients for the performance of others under arrangements described in this paragraph. These contracts typically provide recourse provisions that would allow the Company to recover from the other parties all but approximately \$113 if the Company is obligated to make payments to the clients that are the consequence of a performance default by the other parties. To date, the Company has not been required to make any payments under any of the contracts described in this paragraph. The Company estimates that the fair value of these agreements was minimal. Accordingly, no liabilities have been recorded for these contracts as of September 30, 2007.

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Note 10. Pension and Postretirement Benefits

The components of the Company's net periodic pension cost and post-retirement medical cost for the three and nine months ended September 30, 2007 and 2006 were as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Components of net periodic pension cost:				
Service cost	\$ 1,589	\$ 1,792	\$ 4,767	\$ 5,376
Interest cost	1,165	1,107	3,495	3,321
Expected return on plan assets	(243)	(269)	(729)	(807)
Amortization of loss	95	256	285	768
Amortization of prior service cost	163	159	489	477
Curtailement		30		90
Settlement		(91)		(273)
 Net periodic pension cost	 \$ 2,769	 \$ 2,984	 \$ 8,307	 \$ 8,952
 Components of net periodic postretirement medical cost:				
Service cost	\$ 618	\$ 480	\$ 1,854	\$ 1,440
Interest cost	217	184	651	552
Amortization of losses	13	39	39	117
Amortization of prior service cost	119	120	357	360
 Net periodic postretirement medical cost	 \$ 967	 \$ 823	 \$ 2,901	 \$ 2,469

Note 11. Income Taxes

Effective January 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 supersedes SFAS No. 5, Accounting for Contingencies, as it relates to income tax liabilities and changes the standard of recognition that a tax contingency is required to meet before being recognized in the financial statements. As a result of the adoption of FIN 48, the Company recognized an increase of approximately \$119,845 in its liability for unrecognized tax benefits, which was reflected as an increase to the January 1, 2007 balance of accumulated deficit.

Final determination of a significant portion of the Company's tax liabilities that will effectively be settled remains subject to ongoing examination by various taxing authorities, including the Internal Revenue Service. The Company is aggressively pursuing strategies to favorably settle or resolve these liabilities for unrecognized tax benefits. If the Company is successful in mitigating these liabilities, in whole or in part, the impact will be recorded as an adjustment to income tax expense in the period of settlement.

As of January 1, 2007, the Company had \$282,822 of unrecognized tax benefits. If recognized, \$220,896 would be recognized as a reduction of income tax expense impacting the effective income tax rate. At September 30, 2007, the Company had \$305,633 of unrecognized tax benefits. If recognized, \$236,142 would be recognized as a reduction of income tax expense impacting the effective income tax rate.

The Company is subject to U.S. federal income tax as well as income tax of multiple state and foreign jurisdictions. The Company has concluded substantially all federal income tax matters through June 30, 2001, excluding an open

audit of a \$4,848 federal income tax refund claim. The statute of limitations is open for all remaining years. The Company is currently under audit for the tax periods

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(unaudited)

ended June 30, 2002, June 30, 2003, December 31, 2003, 2004 and 2005. The Company has income tax audits in progress in various state and international jurisdictions in which it operates.

The Company's policy is to recognize interest and penalties related to income tax matters in income tax expense. The Company had \$52,565 accrued for interest and penalties at adoption of FIN 48 and \$63,796 at September 30, 2007. The Company recorded \$3,913 and \$11,231 in interest and penalties during the three and nine months ended September 30, 2007, respectively.

On August 14, 2007, the German Business Tax Reform 2008 was signed and the legislative process was finalized on August 17, 2007 with the official publication of the law. This new legislation changes the German Federal Corporate Tax Rate. The Company has analyzed the impact of these changes on its deferred tax assets and liabilities as of the enactment date. The Company has recorded a net increase to income tax expense of \$2,867 in the quarter ending September 30, 2007 to reflect the impact of the tax rate change.

For the three and nine months ended September 30, 2007, the Company recognized loss before taxes of \$47,526 and \$147,534, respectively, and provided for income taxes of \$20,480 and \$46,205, respectively, resulting in an effective tax rate of (43.1%) and (31.3%), respectively. For the three months ended September 30, 2007, the effective tax rate varied from the U.S. Federal statutory tax rate, primarily as a result of a full valuation allowance established on current period losses in jurisdictions for which it is not more likely than not that a tax benefit will be realized, the mix of income attributable to foreign versus domestic jurisdictions, non-deductible meals and entertainment, changes in income tax reserves, other items, and state and local taxes. For the nine months ended September 30, 2007, the effective tax rate varied from the U.S. Federal statutory tax rate, primarily as a result of a change in valuation allowance, changes in income tax reserves, the mix of income attributable to foreign versus domestic jurisdictions, state and local taxes, non-deductible meals and entertainment and other items.

For the three and nine months ended September 30, 2006, the Company recognized loss before taxes of \$20,775 and \$70,755, respectively, and provided for income taxes of \$8,858 and \$34,444, respectively, resulting in an effective tax rate of (42.6%) and (48.7%), respectively. For the three months ended September 30, 2006, the effective tax rate varied from the U.S. Federal statutory tax rate, primarily as a result of a change in valuation allowance, the mix of income attributable to foreign versus domestic jurisdictions, non-deductible meals and entertainment, changes in income tax reserves, state and local taxes, and other items. For the nine months ended September 30, 2006, the effective tax rate varied from the U.S. Federal statutory tax rate, primarily as a result of a change in valuation allowance, changes in income tax reserves, non-deductible meals and entertainment, state and local taxes, other items, and the mix of income attributable to foreign versus domestic jurisdictions.

Note 12. Recently Issued Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of SFAS 157 are effective for the fiscal year beginning January 1, 2008. The Company is currently evaluating the impact of the provisions of SFAS 157.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of SFAS 115 (SFAS 159). SFAS 159 allows entities to choose, at specific election dates, to measure eligible financial assets and liabilities at fair value that are not otherwise required to be measured at fair value. If a company elects the fair value option for an eligible item, changes in that item's fair value in subsequent reporting periods must be recognized in current earnings. SFAS 159 is effective for the fiscal year beginning January 1, 2008. The Company is currently evaluating the impact of the provisions of SFAS 159.

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PART I, ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) should be read in conjunction with the interim Consolidated Condensed Financial Statements and the Notes to the Consolidated Condensed Financial Statements included elsewhere in this Quarterly Report on Form 10-Q.

Disclosure Regarding Forward-Looking Statements

Some of the statements in this Quarterly Report on Form 10-Q constitute forward-looking statements within the meaning of the United States Private Securities Litigation Reform Act of 1995. These statements relate to our operations that are based on our current expectations, estimates and projections. Words such as may, will, could, would, should, anticipate, predict, potential, continue, expects, intends, plans, projects, believes, our view and similar expressions are used to identify these forward-looking statements. The forward-looking statements contained in this Quarterly Report include statements about our internal control over financial reporting, our results of operations and our financial condition. Forward-looking statements are only predictions and as such are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Forward-looking statements are based upon assumptions as to future events or our future financial performance that may not prove to be accurate. Actual outcomes and results may differ materially from what is expressed or forecast in these forward-looking statements. The reasons for these differences include changes that occur in our continually changing business environment, and the following factors:

Our continuing failure to timely file certain periodic reports with the SEC poses significant risks to our business, each of which could materially and adversely affect our financial condition and results of operations.

In 2004, we identified material weaknesses in our internal control over financial reporting, the remediation of which continues to materially and adversely affect our business and financial condition, and as of September 30, 2007, the existence and remediation of these material weaknesses largely remain.

We face risks related to securities litigation and regulatory actions that could adversely affect our financial condition and business.

Our business may be adversely impacted as a result of changes in demand, both globally and in individual market segments, for our consulting and systems integration services.

Our operating results will suffer if we are not able to maintain our billing and utilization rates or control our costs.

We continue to incur selling, general and administrative (SG&A) expenses at levels significantly higher than those of our competitors. If we are unable to significantly reduce SG&A expenses over the near term, our ability to achieve, and make significant improvements in, net income and profitability will remain in jeopardy.

The systems integration consulting markets are highly competitive, and we may not be able to compete effectively if we are not able to maintain our billing rates or control our costs related to these engagements.

Contracting with the Federal government is inherently risky and exposes us to risks that may materially and adversely affect our business.

Our ability to attract, retain and motivate our managing directors and other key employees is critical to the success of our business. We continue to experience sustained, higher-than-industry average levels of voluntary turnover among our workforce, which has impacted our ability to grow our business.

Our contracts can be terminated by our clients with short notice, or our clients may cancel or delay projects.

If we are not able to keep up with rapid changes in technology or maintain strong relationships with software providers, our business could suffer.

Loss of our joint marketing relationships could reduce our revenue and growth prospects.

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There will not be a consistent pattern in our financial results from quarter to quarter, which may result in increased volatility of our stock price.

Our profitability may decline due to financial, regulatory and operational risks inherent in worldwide operations.

We may bear the risk of cost overruns relating to our services, thereby adversely affecting our profitability.

We may face legal liabilities and damage to our professional reputation from claims made against our work.

Our services may infringe upon the intellectual property rights of others.

We have only a limited ability to protect our intellectual property rights, which are important to our success.

Our current cash resources might not be sufficient to meet our expected cash needs over time.

Our 2007 Credit Facility imposes a number of restrictions on the way in which we operate our business and may negatively affect our ability to finance future needs, or do so on favorable terms. If we violate these restrictions, we will be in default under the 2007 Credit Facility, which may cross-default to our other indebtedness.

If we cannot generate positive cash flow from our operations, we eventually may not be able to service our indebtedness.

We may be unable to obtain new surety bonds, letters of credit or bank guarantees in support of client engagements on acceptable terms.

Downgrades of our credit ratings may increase our borrowing costs and materially and adversely affect our financial condition.

Our leverage may adversely affect our business and financial performance and may restrict our operating flexibility.

The holders of our debentures have the right, at their option, to require us to purchase some or all of their debentures upon certain dates or upon the occurrence of certain designated events, which could have a material adverse effect on our liquidity.

The price of our common stock may decline due to the number of shares that may be available for sale in the future.

There are significant limitations on the ability of any person or company to acquire the Company without the approval of our Board of Directors.

For a more detailed discussion of these factors, please refer to Item 1A, Risk Factors, included in our 2006 Form 10-K and subsequent filings with the SEC.

Overview

We provide strategic consulting applications services, technology solutions and managed services to government organizations, Global 2000 companies and medium-sized businesses in the United States and internationally. In North America, we provide consulting services through our Public Services, Commercial Services and Financial Services industry groups in which we focus

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significant industry-specific knowledge and service offerings to our clients. Outside of North America, we are organized on a geographic basis, with operations in EMEA, the Asia Pacific region and Latin America.

We have started the transition of our business to a more integrated, global delivery model. In 2007, we created a Global Account Management Program and a Global Solutions Council represented by all of our industry groups that will focus on identifying opportunities for globalized solutions suites. Our Global Development Centers continue to grow, both in terms of personnel and the percentage of work they provide to our industry groups.

Economic and Industry Factors

We believe that our clients' spending for consulting services is partially correlated to, among other factors, the performance of the domestic and global economy as measured by a variety of indicators such as gross domestic product, government policies, mergers and acquisitions activity, corporate earnings, U.S. Federal and state government budget levels, inflation and interest rates and client confidence levels, among others. As economic uncertainties increase, clients' interests in business and technology consulting historically have turned more to improving existing processes and reducing costs rather than investing in new innovations. Demand for our services, as evidenced by new contract bookings, also does not uniformly follow changes in economic cycles. Consequently, we may experience rapid decreases in new contract bookings at the onset of significant economic downturns while the benefits of economic recovery may take longer to realize.

The markets in which we provide services are increasingly competitive and global in nature. While supply and demand in certain lines of business and geographies may support price increases for some of our standard service offerings from time to time, to maintain and improve our profitability we must constantly seek to improve and expand our unique service offerings and deliver our services at increasingly lower cost levels. Our Public Services industry group, which is our largest, also must operate within the U.S. Federal, state and local government markets where unique contracting, budgetary and regulatory regimes control how contracts are awarded, modified and terminated. Budgetary constraints or reductions in government funding may result in the modification or termination of long-term government contracts, which could dramatically affect the outlook of that business.

Revenue and Income Drivers

We derive substantially all of our revenue from professional services activities. Our revenue is driven by our ability to continuously generate new opportunities to serve clients, by the prices we obtain for our service offerings, and by the size and utilization of our professional workforce. Our ability to generate new business is directly influenced by the economic conditions in the industries and regions we serve, our anticipation and response to technological change, the type and level of technology spending by our clients and by our clients' perception of the quality of our work. Our ability to generate new business is also indirectly influenced by our clients' perceptions of our ability to manage our ongoing issues surrounding our financial position and SEC reporting capabilities.

Our gross profit consists of revenue less our costs of service. The primary components of our costs of service include professional compensation and other direct contract expenses. Professional compensation consists of payroll costs and related benefits associated with client service professional staff (including the vesting of various stock awards, tax equalization for employees on foreign and long-term domestic assignments, bonuses and costs associated with reductions in workforce). Other direct contract expenses include costs directly attributable to client engagements. These costs include out-of-pocket costs such as travel and subsistence for client service professional staff, costs of hardware and software, and costs of subcontractors. If we are unable to adequately control or estimate these costs, or properly anticipate the sizes of our client service and support staff, our profitability will suffer.

Our operating profit reflects our revenue less costs of service and certain additional items that include, primarily, SG&A expenses, which include costs related to marketing, information systems, depreciation and amortization, finance and accounting, human resources, sales force, and other expenses related to managing and growing our business. Write-downs in the carrying value of goodwill and amortization of intangible assets have also historically reduced our operating profit.

Our operating cash flow is derived predominantly from gross operating profit and how we manage our receivables and payables.

Key Performance Indicators

In evaluating our operating performance and financial condition, we focus on the following key performance indicators: bookings, revenue growth, gross margin (gross profit as a percentage of revenue), utilization, days sales outstanding, free cash flow and attrition.

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Bookings. We believe that information regarding our new contract bookings provides useful trend information regarding how the volume of our new business changes over time. Comparing the amount of new contract bookings and revenue provides us with an additional measure of the short-term sustainability of revenue growth. Information regarding our new bookings should not be compared to, or substituted for, an analysis of our revenue over time. There are no third-party standards or requirements governing the calculation of bookings. New contract bookings are recorded using then existing currency exchange rates and are not subsequently adjusted for currency fluctuations. These amounts represent our estimate at contract signing of the net revenue expected over the term of that contract and involve estimates and judgments regarding new contracts as well as renewals, extensions and additions to existing contracts. Subsequent cancellations, extensions and other matters may affect the amount of bookings previously reported; however, we do not revise previously reported bookings. Bookings do not include potential revenue that could be earned from a client relationship as a result of future expansion of service offerings to that client, nor does it reflect option years under contracts that are subject to client discretion. We do not record unfunded Federal contracts as new contract bookings while appropriation approvals remain pending as there can be no assurances that these approvals will be forthcoming in the near future, if at all. Consequently, there can be significant differences between the time of contract signing and new contract booking recognition. Although our level of bookings provides an indication of how our business is performing, we do not characterize our bookings, or our engagement contracts associated with new bookings, as backlog because our engagements generally can be cancelled or terminated on short notice or without notice.

Revenue Growth. Unlike bookings, which provide only a general sense of future expectations, period-over-period comparisons of revenue provide a meaningful depiction of how successful we have been in growing our business over time.

Gross Margin (gross profit as a percentage of revenue). Gross margin is a meaningful tool for monitoring our ability to control our costs of services. Analysis of the various cost elements, including professional compensation expense, effects of foreign exchange rate changes and the use of subcontractors, as a percentage of revenue over time can provide additional information as to the key challenges we are facing in our business. The cost of subcontractors is generally more expensive than the cost of our own workforce and can negatively impact our gross profit. While the use of subcontractors can help us to win larger, more complex deals, and also may be mandated by our clients, we focus on limiting the use of subcontractors whenever possible in order to minimize our costs. We also utilize certain adjusted gross margin metrics in connection with the vesting and settlement of certain employee incentive awards. For a discussion of these metrics, see Executive Compensation Compensation Discussion and Analysis, included in our proxy statement related to our 2007 Annual Meeting of Stockholders, filed with the SEC on September 28, 2007.

Utilization. Utilization represents the percentage of time our consultants are performing work, and is defined as total hours charged to client engagement or to non-chargeable client-relationship projects divided by total available hours for any specific time period, net of holiday and paid vacation hours.

Days Sales Outstanding (DSO). DSO is an operational metric that approximates the amount of earned revenue that remains unpaid by clients at a given time. DSOs are derived by dividing the sum of our outstanding accounts receivable and unbilled revenue, less deferred revenue, by our average net revenue per day. Average net revenue per day is determined by dividing total net revenue for the most recently ended trailing twelve-month period by 365.

Free Cash Flow. Free cash flow is calculated by subtracting purchases of property and equipment from cash provided by operating activities. We believe free cash flow is a useful measure because it allows better understanding and assessment of our ability to meet debt service requirements and the amount of recurring

cash generated from operations after expenditures for fixed assets. Free cash flow does not represent our residual cash flow available for discretionary expenditures as it excludes certain mandatory expenditures such as repayment of maturing debt. We use free cash flow as a measure of recurring operating cash flow. Free cash flow is a non-GAAP financial measure. The most directly comparable financial measure calculated in accordance with GAAP is net cash provided by operating activities.

Attrition. Attrition, or voluntary total employee turnover, is calculated by dividing the number of our employees who have chosen to leave the Company within a certain period by the total average number of all employees during that same period. Our attrition statistic covers all of our employees, which we believe provides metrics that are more compatible with, and comparable to, those of our competitors.

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Readers should understand that each of the performance indicators identified above are utilized by many companies in our industry and by those who follow our industry. There are no uniform standards or requirements for computing these performance indicators, and, consequently, our computations of these amounts may not be comparable to those of our competitors.

Three and Nine Months Ended September 30, 2007 Highlights

A summary of our financial highlights for the three and nine months ended September 30, 2007 is presented below.

New contract bookings for the three months ended September 30, 2007 were \$764.1 million, a decrease of \$49.2 million, or 6.0%, from new contract bookings of \$813.3 million for the three months ended September 30, 2006. Increases in new bookings in our Public Services business unit were more than offset by significant year-over-year declines in new contract bookings in our Commercial Services and Financial Services business units. Our geographic business units also experienced modest year-over-year new contract booking decreases which, collectively, contributed to the decrease in new contract bookings.

New contract bookings for the nine months ended September 30, 2007 were \$2,220.5 million, a decrease of \$210.5 million, or 8.7%, from new contract bookings of \$2,431.0 million for the nine months ended September 30, 2006. Increases in new contract bookings in our EMEA and Asia Pacific business units were more than offset by significant declines in new contract bookings in our other business units. Year-over-year decreases in Public Services bookings for the nine months ended September 30, 2007 were substantially attributable to the signing of several exceptionally large bookings in our State, Local and Education (SLED) sector in early 2006. While we are beginning to see improvements in Commercial Services, our telecommunications practice continues to struggle to position itself in a contracting marketplace. Furthermore, our Financial Services business unit has been unable to rapidly rebound from perceptions raised late last year surrounding our financial stability. Given the current uncertainties and continuing loss write-downs in the commercial and investment banking sector, it is unlikely that new contract bookings levels within Financial Services will return to historical levels before mid-2008 at the earliest.

Our revenue for the three months ended September 30, 2007 was \$861.9 million, an increase of \$18.6 million, or 2.2%, over revenue for the three months ended September 30, 2006 of \$843.2 million. Revenue increases in Public Services, EMEA, Latin America and Asia Pacific exceeded revenue declines in Financial Services and Commercial Services. Our revenue for the nine months ended September 30, 2007 was \$2,603.5 million, an increase of \$33.8 million, or 1.3%, over revenue for the nine months ended September 30, 2006 of \$2,569.7 million. Revenue increases in Public Services, EMEA and Latin America exceeded revenue declines in Financial Services, Commercial Services and Asia Pacific. In analyzing year-over-year revenue growth for the nine months ended September 30, 2007, consideration must also be given to the effect in fiscal 2006 of two previously disclosed settlements within the telecommunications industry and the recognition of certain deferred revenue, the net combined effect of which negatively impacted our revenue for the first nine months of fiscal 2006 by approximately \$27 million.

Our gross profit for the three months ended September 30, 2007 was \$132.6 million, a decrease of \$26.3 million, or 16.6%, from gross profit for the three months ended September 30, 2006 of \$159.0 million. Gross profit as a percentage of revenue decreased to 15.4% during the three months ended September 30, 2007 from 18.9% during the three months ended September 30, 2006. This decline was primarily the result of relatively comparable increases in professional compensation expense associated with salaries and benefits and with stock based compensation, the latter being primarily related to our February 2007 grant of PSUs. Our gross profit for the nine months ended September 30, 2007 was \$407.2 million, a decrease of \$41.8 million, or 9.3%, from gross profit of \$449.0 million for the nine months ended September 30, 2006. Gross profit as a percentage of revenue decreased to 15.6% during the nine months ended September 30, 2007 from 17.5% during the nine months ended September 30, 2006. Revenue improvements and significant decreases in other direct contract expenses were outstripped by increases in professional compensation expense, with the most significant portion of these increases attributable to expenses associated with salaries and benefits.

We incurred SG&A expenses of \$160.3 million in the third quarter of 2007, representing a decrease of \$13.0 million, or 7.5%, from SG&A expenses of \$173.3 million in the third quarter of 2006. We incurred SG&A expenses of \$512.3 million in the nine months ended September 30, 2007, representing a decrease of \$26.3 million, or 4.9%, from SG&A expenses of \$538.6 million in the nine months ended September 30, 2006. The decreases in SG&A expense in both periods were primarily due to reduced costs directly related to the closing of our financial statements and subcontracted labor, as well as savings from the reduction in the size of our sales force. Partially offsetting these savings was increased compensation expense for additional

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SG&A personnel, stock-based compensation expense related to our February 2007 grant of PSUs, RSUs, and bonuses.

During the three months ended September 30, 2007, we incurred external costs of approximately \$14.0 million related to the preparation of our financial statements, our auditors' review of our financial statements and the testing of internal controls, compared with approximately \$32.1 million for the three months ended September 30, 2006. During the nine months ended September 30, 2007, these external costs were approximately \$67.4 million, compared with approximately \$99.6 million for the nine months ended September 30, 2006. We currently expect our costs for the remainder of 2007 related to these efforts to be approximately \$12.8 million, compared with \$28.6 million incurred in the fourth quarter of 2006.

During the third quarter of 2007, we realized a net loss of \$68.0 million, or a loss of \$0.32 per share, representing an increase of \$38.4 million over a net loss of \$29.6 million, or a loss of \$0.14 per share, during the third quarter of 2006. This change in net loss was primarily attributable to:

a decrease in gross profit of \$26.3 million;

an increase in interest expense of \$8.9 million in the third quarter of 2007, due to interest attributable to our 2007 Credit Facility; and

an increase in income tax expense of \$11.6 million in the third quarter of 2007.

The increase in net loss was partially offset by a decrease in SG&A expenses of \$13.0 million in the third quarter of 2007.

During the nine months ended September 30, 2007, we realized a net loss of \$193.7 million, or a loss of \$0.90 per share, representing an increase of \$88.5 million over a net loss of \$105.2 million, or a loss of \$0.50 per share, during the nine months ended September 30, 2006. This change in net loss was primarily attributable to:

a decrease in gross profit of \$41.8 million;

the recognition of \$38.0 million in other income in the first quarter of 2006 in connection with insurance settlement payments made on behalf of the Company in connection with the settlement of our contract with Hawaiian Telcom Communications, Inc. (HT);

an increase in interest expense of \$17.6 million in the nine months ended September 30, 2007, due to interest attributable to our 2007 Credit Facility and the acceleration of debt issuance costs resulting from the termination of the 2005 Credit Facility; and

an increase in income tax expense of \$11.8 million in the nine months ended September 30, 2007.

The increase in net loss was partially offset by a decrease in SG&A expenses of \$26.3 million in the nine months ended September 30, 2007.

Effective January 1, 2007, we adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes. FIN 48 supersedes SFAS No. 5, Accounting for Contingencies, as it relates to income tax liabilities and changes the standard of recognition that a tax contingency is required to meet before being recognized in the financial statements. Upon adoption of FIN 48 and after examining our existing tax contingencies under the standards of FIN 48, we recognized an increase of approximately \$119.8 million in our long-term liability for unrecognized tax benefits, which was reflected as an increase to the January 1, 2007 balance of accumulated deficit.

Final determination of a significant portion of the Company's tax liabilities that will effectively be settled remains subject to ongoing examination by various taxing authorities, including the Internal Revenue Service. We are aggressively pursuing strategies to favorably settle or resolve these liabilities for unrecognized tax benefits. If we are successful in mitigating these liabilities, in whole or in part, the majority of the impact will

be recorded as an adjustment to income tax expense in the period of settlement.

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Utilization for the three months ended September 30, 2007 was 78.5%, an increase of 130 basis points over the three months ended September 30, 2006. Utilization for the nine months ended September 30, 2007 was 77.2%, an increase of 140 basis points over the nine months ended September 30, 2006.

As of September 30, 2007, our DSOs stood at 90 days, representing a decrease of 6 days, or 6.3%, from our DSOs at September 30, 2006.

Free cash flow for the three months ended September 30, 2007 and 2006 was \$67.2 million and \$19.8 million, respectively. Net cash provided from operating activities in the three months ended September 30, 2007 and 2006 was \$76.5 million and \$27.8 million, respectively. Purchases of property and equipment in the three months ended September 30, 2007 and 2006 were \$9.2 million and \$8.1 million, respectively. The year-over-year change in free cash flow for the three-month period ended September 30, 2007 is primarily attributable to increases in accrued liabilities primarily associated with accounts payable and an increase in accrued taxes greater than cash taxes paid.

Free cash flow for the nine months ended September 30, 2007 and 2006 was (\$253.8) million and (\$104.8) million, respectively. Net cash used in operating activities in the nine months ended September 30, 2007 and 2006 was (\$222.0) million and (\$74.5) million, respectively. Purchases of property and equipment in the nine months ended September 30, 2007 and 2006 were \$31.8 million and \$30.3 million, respectively. The decrease in free cash flow for the nine-month period was primarily attributable to significant increases to our combined accounts receivable and unbilled revenue, which resulted in an increase in DSOs since December 31, 2006, significant reductions in our accounts payable due to timing of vendor payments, settlement of certain legal matters, and to a lesser extent, an increase in net loss, net of non-cash items.

As of September 30, 2007, we had approximately 17,300 full-time employees, including approximately 14,500 consulting professionals. This represented a decrease in billable headcount of approximately 5.2% from our headcount as of December 31, 2006, due in part to the redeployment of existing employees to practice support roles.

Our voluntary, annualized attrition rate for the third quarter of 2007 was 26.6%, compared with 28.3% for the third quarter of 2006. The highly competitive industry in which we operate and our financial position continues to make it particularly critical and challenging for us to attract and retain experienced personnel.

Effective as of October 22, 2007, our Board of Directors approved an amendment to our existing shareholder rights agreement. As amended, a shareholder's right under the agreement to acquire additional shares of stock will not trigger unless (a) a shareholder who is a passive investor acquires 20% or more of our common stock or (b) a shareholder who is not a passive investor acquires 15% or more of our common stock. Prior to the amendment, these rights were triggered upon a shareholder acquiring 15% or more of our common stock in all instances.

We have initiated our plans to deliver shares to our employees under our various employee share plans over the coming quarters. For additional information see Item 1A, Risk Factors, of this Quarterly Report.

Principal Business Priorities and Strategies for 2007 and Beyond

In early 2007 our Board of Directors determined our principal business priorities to be to: (1) enhance shareholder value, (2) become timely in our financial and SEC periodic reporting, (3) replace our North American financial reporting systems, (4) reduce employee attrition, (5) increase client awareness, confidence and satisfaction, and (6) strengthen our balance sheet. For information on management's current and planned initiatives to achieve the priorities established by our Board of Directors, please refer to our 2006 Form 10-K.

We provide the following as updates on our progress and challenges with respect to certain of these priorities:

Enhance Shareholder Value.

While we continue to make strides in improving our internal operations, our business strategy must represent our path forward and our primary focus for enhancing shareholder value. Four themes encompass our strategic vision:

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Focus We will continue to selectively target and focus on clients, markets and offerings where we can be a market leader. We will strategically leverage our industry and solution expertise along with our business partners and other core channels to market to effectively deliver our firm's capabilities in these areas.

Differentiated Solutions We will continue to target and invest in solutions which are highly relevant to our clients' needs and which we can provide in a compelling, differentiated manner. Our offerings and capabilities in Risk, Compliance and Security illustrate the outcomes of this priority.

Global Model Our clients operate globally and so do we. We are very committed to our global delivery model, and we will maintain world class on-shore and off-shore capabilities to meet the ever changing needs of our clients.

Our EMEA segment will continue to be a key part of our strategy. After extensive analysis and discussion, we have concluded that over the long term, we can create more value for our shareholders, our customers and our people by further integrating our businesses and operating model, not distancing them. Consequently, we have decided to continue to own and operate our EMEA segment as part of our consolidated business.

People Our professionals are the lifeblood of our company. We continue to invest in our ability to attract, develop and retain the best and the brightest. Our investments in training and our partnership with the prestigious Yale University are examples of our commitment.

Become Timely in our Financial and SEC Periodic Reporting. We continue to target timely filing with the SEC of our Annual Report on Form 10-K for the year ending December 31, 2007. With the filing of this Quarterly Report, we are current and up to date in our SEC periodic reports.

To date in 2007, substantial progress continues to be made in remediating material weaknesses in our internal control over financial reporting. Based on our management team's most recent review, we believe it is possible that certain material weaknesses disclosed in our 2006 Form 10-K, including those with respect to processes and controls related to facilities management, property and equipment, costs associated with cross-border travelers, and income taxes can be remediated in 2007. We do not expect material weaknesses related to revenue recognition and accounts payable disclosures to be completely remediated before 2008. Full remediation can only be achieved after appropriate internal assessment, including testing and auditing procedures have been completed, therefore, the exact date of full remediation of each material weakness remains subject to change.

Replace Our North American Financial Reporting Systems. We are still planning to begin our transition to new North American financial reporting systems in the second half of 2008. The strategy, design and build phases for the project are proceeding. In the interim, it is critical that we continue to make incremental improvements on our existing North American financial reporting systems to be able to support and achieve our goal of remaining timely in our SEC periodic reporting in fiscal 2008.

Reduce Employee Attrition. We have seen some improvement in our voluntary employee attrition rate during the third quarter of 2007. We are optimistic that becoming timely in our financial and SEC periodic reporting and again being able to focus singularly on our business strategy will continue to improve our attrition rates.

Increase Client Awareness, Confidence and Satisfaction. To date in 2007, we were named as a leading provider of risk consulting by Forrester in its 2007 vendor summary and as 2007 Global System Integrator of the Year by Cognos for the second year in a row. In addition, we ranked 24th in Washington Technology Magazine's

2007 ranking of Top 100 government contractors.

Strengthen Our Balance Sheet.

Continued SG&A Reductions We are also moving on plans to aggressively reduce our ongoing SG&A expenditures by the end of fiscal 2007. We hope to be able to reduce fiscal 2007 SG&A costs by approximately \$60 million year-over-year. A significant portion of these savings are expected to come from year-over-year savings in the external costs associated with completing our consolidated financial statements and filing our SEC periodic reports and, based on our activities through September 30, 2007, we continue to believe these external cost savings are achievable.

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To achieve further reductions in 2008 and beyond, we must continue to reduce the relatively high SG&A costs that we continue to experience in a number of areas of our corporate infrastructure and business segments. We also continue to strive to improve our cash collections through a program recently initiated by our Office of the Chief Executive Officer. At September 30, 2007, our DSOs stood at 90 days. If we are to generate significant amounts of cash from operations in the latter part of 2007, by the fourth fiscal quarter of 2007 we must again exceed our cash collections for the fourth quarter of fiscal 2006 when our DSOs stood at 82 days.

In 2008, we expect to continue to improve our quarterly DSO balances and increase our operational focus on improving operating margins. We will begin to consider exiting particular sectors and markets where we do not think we can achieve and sustain satisfactory operating margins.

Segments

Our reportable segments for 2007 consist of our three North America industry groups (Public Services, Commercial Services, and Financial Services), our three international regions (EMEA, Asia Pacific and Latin America) and the Corporate/Other category (which consists primarily of infrastructure costs). Revenue and gross profit information about our segments are presented below, starting with each of our industry groups and then with each of our three international regions (in order of size).

Our chief operating decision maker, the Chief Executive Officer, evaluates performance and allocates resources among the segments. Upon consolidation, all intercompany accounts and transactions are eliminated. Inter-segment revenue is not included in the measure of profit or loss for each reportable segment. Performance of the segments is evaluated on operating income excluding the costs of infrastructure functions (such as information systems, finance and accounting, human resources, legal and marketing) as described in Note 6, Segment Reporting, of the Notes to Consolidated Condensed Financial Statements.

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Revenue. Our revenue for the third quarter of 2007 was \$861.9 million, an increase of \$18.6 million, or 2.2%, over revenue of \$843.2 million for the third quarter of 2006. The following tables present certain revenue information and performance metrics for each of our reportable segments for the third quarters of 2007 and 2006. Amounts are in thousands, except percentages.

	Three Months Ended September 30,			% Change
	2007	2006	\$ Change	
Revenue				
Public Services	\$ 362,893	\$ 333,825	\$ 29,068	8.7%
Commercial Services	131,383	133,253	(1,870)	(1.4%)
Financial Services	66,412	97,161	(30,749)	(31.6%)
EMEA	184,318	167,089	17,229	10.3%
Asia Pacific	94,081	91,609	2,472	2.7%
Latin America	22,240	18,758	3,482	18.6%
Corporate/Other	570	1,553	(983)	n/m
Total	\$ 861,897	\$ 843,248	\$ 18,649	2.2%

	Impact of currency fluctuations	Revenue growth (decline), net of currency impact	Total
Revenue			
Public Services	0.0%	8.7%	8.7%
Commercial Services	0.0%	(1.4%)	(1.4%)
Financial Services	0.0%	(31.6%)	(31.6%)
EMEA	7.9%	2.4%	10.3%
Asia Pacific	2.0%	0.7%	2.7%
Latin America	11.0%	7.6%	18.6%
Corporate/Other	n/m	n/m	n/m
Total	2.0%	0.2%	2.2%

n/m = not meaningful

Public Services revenue increased during the third quarter of 2007, led by significant revenue growth in our Emerging Markets, SLED and Civilian sectors. Partially offsetting these increases was a revenue decline in our Healthcare sector, which, based on improved new contract bookings for the third fiscal quarter of 2007, appears to be a function of ordinary contracting and booking cycles.

Commercial Services revenue slightly decreased during the third quarter of 2007, primarily due to reduced customer demand for our services within the high technology and telecommunications industries. This decrease was partially offset by increases in the energy and life sciences industries.

Financial Services revenue decreased during the third quarter of 2007, due to significant revenue declines across all business sectors. Revenue decreases were attributable to several factors, including the winding down of the business unit's largest client engagement during 2007, the continuing effects of losses of senior staff in certain of our higher rate business sectors and early termination of some engagements by banking sector clients in response to recently reported losses related to asset write-downs.

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EMEA revenue increased during the third quarter of 2007, primarily as a result of the favorable impact of the strengthening of foreign currencies (primarily the Euro) against the U.S. dollar but also due to significant revenue increases in Switzerland and Russia. These increases were partially offset by revenue declines in the Netherlands and United Kingdom.

Asia Pacific revenue increased during the third quarter of 2007, primarily as a result of the favorable impact of the strengthening of foreign currencies against the U.S. dollar. Significant revenue growth was achieved in Japan resulting from increased demand for our services related to system implementation contracts and projects involving compliance with Japan's Financial Instruments and Exchange Law, however, this growth was substantially offset by revenue declines in other countries.

Latin America revenue increased during the third quarter of 2007, as a result of revenue growth derived from the strengthening of our relationships with existing clients in Mexico and Brazil, as well as the favorable impact of the strengthening of foreign currencies (primarily the Brazilian Real) against the U.S. dollar.

Corporate/Other: Our Corporate/Other segment does not contribute significantly to our revenue.

Gross Profit. During the third quarter of 2007, our revenue increased \$18.6 million and total costs of service increased \$45.0 million when compared to the third quarter of 2006, resulting in a decrease in gross profit of \$26.3 million, or 16.6%. Gross profit as a percentage of revenue decreased to 15.4% for the third quarter of 2007 from 18.9% for the third quarter of 2006. The change in gross profit for the third quarter of 2007 compared to the third quarter of 2006 resulted primarily from the following:

Professional compensation expense increased as a percentage of revenue to 50.9% for the third quarter of 2007, compared to 48.8% for the third quarter of 2006. We experienced a net increase in professional compensation expense of \$27.8 million, or 6.8%, to \$438.9 million for the third quarter of 2007 from \$411.1 million for the third quarter of 2006. The increase in professional compensation expense over the third quarter of 2006 was primarily due to stock-based compensation expense relating to PSUs and merit-based annual salary increases to our billable staff.

Other direct contract expenses decreased as a percentage of revenue to 23.8% for the third quarter of 2007, compared to 25.4% for the third quarter of 2006. We experienced a net decrease in other direct contract expenses of \$9.6 million, or 4.5%, to \$204.7 million for the third quarter of 2007 from \$214.3 million for the third quarter of 2006. The decrease was driven by reduced subcontractor expenses as a result of increased use of internal resources.

Other costs of service as a percentage of revenue increased to 9.5% for the third quarter of 2007 from 6.9% for the third quarter of 2006. We experienced a net increase in other costs of service of \$23.9 million, or 41.2%, to \$81.8 million for the third quarter of 2007 from \$57.9 million for the third quarter of 2006. The increase was primarily due to increases in the number of non-billable employees, higher recruiting costs and a software impairment charge recorded within EMEA. The increase in the number of non-billable employees was due in part to the redeployment of existing employees from client-facing roles to practice support roles, which results in related salaries and expenses now being reflected in other costs of service rather than professional expense.

During the third quarter of 2007 we recorded, within the Corporate/Other operating segment, a restructuring charge of \$3.9 million related to lease, facilities and other exit activities, compared with a \$1.0 million charge during the third quarter of 2006. These charges related primarily to the fair value of future lease obligations associated with office space, which we will no longer be using, primarily within the EMEA and North America regions.

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Gross Profit by Segment. The following tables present certain gross profit and margin information and performance metrics for each of our reportable segments for the third quarters of 2007 and 2006. Amounts are in thousands, except percentages.

	Three Months Ended September 30,			%
	2007	2006	\$ Change	Change
Gross Profit				
Public Services	\$ 73,283	\$ 69,190	\$ 4,093	5.9%
Commercial Services	27,235	26,735	500	1.9%
Financial Services	12,873	32,403	(19,530)	(60.3%)
EMEA	31,044	35,005	(3,961)	(11.3%)
Asia Pacific	24,064	23,823	241	1.0%
Latin America	(1,916)	1,071	(2,987)	n/m
Corporate/Other	(33,963)	(29,258)	(4,705)	n/m
Total	\$ 132,620	\$ 158,969	\$ (26,349)	(16.6%)

	Three Months Ended September 30,	
	2007	2006
Gross Profit as a % of revenue		
Public Services	20.2%	20.7%
Commercial Services	20.7%	20.1%
Financial Services	19.4%	33.3%
EMEA	16.8%	20.9%
Asia Pacific	25.6%	26.0%
Latin America	(8.6%)	5.7%
Corporate/Other	n/m	n/m
Total	15.4%	18.9%

n/m = not
meaningful

Changes in gross profit by segment were as follows:

Public Services gross profit increased in the third quarter of 2007, primarily due to an increase in revenue combined with a substantial improvement in gross profit in our SLED sector. Gross profit improvement in the SLED sector was driven by both current quarter revenue growth and the absence of significant amounts of other direct contract expenses recorded in the third fiscal quarter of 2006 attributable to two completed contracts. This increase was offset by increases in professional compensation expense related to increases in stock-based compensation expense and, to a lesser extent, additional personnel to meet the demand for our services.

Commercial Services gross profit slightly increased in the third quarter of 2007, as savings in other direct contract expenses due to the reduced use of subcontractors more than offset lower revenue.

Financial Services gross profit significantly decreased in the third quarter of 2007, primarily due to significantly lower revenue in the third quarter of 2007 compared with the third quarter of 2006. Despite a decrease in billable personnel, compensation expense decreased at a slower pace due to an increase in

stock-based compensation expense primarily attributable to PSUs.

EMEA gross profit decreased in the third quarter of 2007, primarily due to an increase in professional compensation resulting from an increase in billable personnel, and to a lesser extent, an increase in other costs of services largely attributable to an asset impairment charge. This increase was partially offset by overall higher revenue in the EMEA region and improved profitability in Germany.

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Asia Pacific gross profit slightly increased in the third quarter of 2007, primarily due to significant improvements in profitability and staff utilization in the Company's business in Japan. Other direct contract expenses significantly decreased as a result of reduced use of subcontractors and increased use of internal resources.

Latin America gross profit decreased in the third quarter of 2007, as increases in compensation expense, driven by higher billable personnel to meet the growth of our business, primarily in Brazil, more than offset revenue growth in the region.

Corporate/Other consists primarily of rent expense and other facilities related charges, which increased in the third quarter of 2007 primarily due to the lease and facilities restructuring charges discussed above.

Amortization of Purchased Intangible Assets. We did not incur any amortization expense in the third quarter of 2007, as our intangible assets were fully amortized. Amortization of purchased intangible assets was \$0.5 million in the third quarter of 2006.

Selling, General and Administrative Expenses. We incurred SG&A expenses of \$160.3 million for the three months ended September 30, 2007, representing a decrease of \$13.0 million, or 7.5%, from SG&A expenses of \$173.3 million for the three months ended September 30, 2006. SG&A expenses as a percentage of gross revenue decreased to 18.6% in the three months ended September 30, 2007 from 20.6% for the three months ended September 30, 2006. The decrease was primarily due to reduced costs directly related to the closing of our financial statements and subcontracted labor. Partially offsetting these decreases were increased compensation expense for additional SG&A personnel and stock-based compensation expense for PSUs.

Interest Income. Interest income was \$3.1 million and \$1.6 million in the three months ended September 30, 2007 and 2006, respectively. Interest income is earned primarily from cash and cash equivalents, including money-market investments. The increase in interest income was due to a higher level of cash available to be invested in money-markets during the third quarter of 2007 as compared to the third quarter of 2006.

Interest Expense. Interest expense was \$17.5 million and \$8.6 million in the three months ended September 30, 2007 and 2006, respectively. Interest expense is attributable to our debt obligations, consisting of interest due along with amortization of loan costs and loan discounts. The increase in interest expense was due to interest attributable to our 2007 Credit Facility entered into on May 18, 2007.

Other (Expense) Income, net. Other expense, net was \$5.4 million in the three months ended September 30, 2007, compared with other income, net of \$1.2 million in the three months ended September 30, 2006. The balances in each period primarily consisted of unrealized foreign currency exchange losses and gains.

Income Tax Expense. We incurred income tax expense of \$20.5 million and \$8.9 million for the three months ended September 30, 2007 and 2006, respectively. The principal reasons for the difference between the effective income tax rates on loss from continuing operations of (43.1%) and (42.6%) for the three months ended September 30, 2007 and 2006, respectively, were: a change in valuation allowance; changes in income tax reserves; the mix of income attributable to foreign versus domestic jurisdictions; state and local taxes; other items and non-deductible meals and entertainment.

Net Loss. For the three months ended September 30, 2007, we incurred a net loss of \$68.0 million, or a loss of \$0.32 per share. For the three months ended September 30, 2006, we incurred a net loss of \$29.6 million, or a loss of \$0.14 per share. Contributing to the net loss for the three months ended September 30, 2007 was stock-based compensation expense of \$29.4 million, as compared to stock-based compensation expense of \$12.4 million for the three months ended September 30, 2006.

Table of Contents**Nine Months ended September 30, 2007 Compared to Nine Months ended September 30, 2006**

Revenue. Our revenue for the nine months ended September 30, 2007 was \$2,603.5 million, an increase of \$33.8 million, or 1.3%, over revenue of \$2,569.7 million for the nine months ended September 30, 2006. The following tables present certain revenue information and performance metrics for each of our reportable segments for the nine months ended September 30, 2007 and 2006. Amounts are in thousands, except percentages.

	Nine Months Ended September 30,			% Change
	2007	2006	\$ Change	
Revenue				
Public Services	\$ 1,084,080	\$ 1,006,022	\$ 78,058	7.8%
Commercial Services	401,638	409,683	(8,045)	(2.0%)
Financial Services	209,378	319,833	(110,455)	(34.5%)
EMEA	570,111	501,696	68,415	13.6%
Asia Pacific	267,161	271,671	(4,510)	(1.7%)
Latin America	67,787	56,639	11,148	19.7%
Corporate/Other	3,340	4,128	(788)	n/m
Total	\$ 2,603,495	\$ 2,569,672	\$ 33,823	1.3%

	Impact of currency fluctuations	Revenue growth (decline), net of currency impact	Total
Revenue			
Public Services	0.0%	7.8%	7.8%
Commercial Services	0.0%	(2.0%)	(2.0%)
Financial Services	0.0%	(34.5%)	(34.5%)
EMEA	8.4%	5.2%	13.6%
Asia Pacific	0.5%	(2.2%)	(1.7%)
Latin America	7.9%	11.8%	19.7%
Corporate/Other	n/m	n/m	n/m
Total	1.9%	(0.6%)	1.3%

n/m = not meaningful

Public Services revenue increased during the nine months ended September 30, 2007, led by significant revenue growth in our Emerging Markets, SLED and Civilian sectors. Partially offsetting these increases were revenue declines in our Defense and Healthcare sectors, both of which have since experienced positive new contract booking increases in the fiscal quarter ended September 30, 2007.

Commercial Services revenue decreased during the nine months ended September 30, 2007, primarily due to reduced customer demand for our services within the telecommunications and high technology industries. These decreases were partially offset by increased revenue in our Manufacturing, Energy and Consumer Markets sector due to greater demand for the solutions provided by our professionals who service this sector.

Financial Services revenue decreased during the nine months ended September 30, 2007, due to significant revenue declines in all of its business sectors. Revenue decreases were attributable to several factors, including the winding down of the business unit's largest client engagement during 2007, the continuing effects of losses of senior staff in certain of our higher rate business sectors and difficulties in securing long-term client commitments, due in part to client concerns and perceptions generated earlier this year regarding our financial position.

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EMEA revenue increased during the nine months ended September 30, 2007, primarily as a result of the favorable impact of the strengthening of foreign currencies (primarily the Euro) against the U.S. dollar but also due to significant revenue increases in Switzerland, Russia, the United Kingdom and France. These increases were partially offset by revenue declines in Germany. Switzerland, Russia and France revenue growth were attributable to increased demand for consulting services in those local markets, while revenue growth in the United Kingdom was driven by our continued expansion in that market. Revenue in Germany decreased due to prior year restructuring efforts, resulting in continued reductions in billable personnel while increasing focus on delivering more profitable engagements.

Asia Pacific revenue decreased during the nine months ended September 30, 2007, primarily due to a decline in revenue recognized in Australia at a significant client engagement in the telecommunications industry and a revenue decline in Korea due to the completion of several large contracts, partially offset by revenue growth in Japan and China. The revenue increase in Japan was due to revenue growth from system implementation contracts and projects involving compliance with Japan's Financial Instruments and Exchange Law, while revenue growth in China resulted from an increased operational focus.

Latin America revenue increased during the nine months ended September 30, 2007, primarily as a result of revenue growth in Mexico and Brazil and the strengthening of our relationships with existing clients. Latin America revenue was also positively impacted by the strengthening of foreign currencies (primarily the Brazilian Real) against the U.S. dollar.

Corporate/Other: Our Corporate/Other segment does not contribute significantly to our revenue.

Gross Profit. During the nine months ended September 30, 2007, our revenue increased \$33.8 million and total costs of service increased \$75.6 million when compared to the nine months ended September 30, 2006, resulting in a decrease in gross profit of \$41.8 million, or 9.3%. Gross profit as a percentage of revenue decreased to 15.6% for the nine months ended September 30, 2007 from 17.5% for the nine months ended September 30, 2006. The change in gross profit for the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006 resulted primarily from the following:

Professional compensation expense increased as a percentage of revenue to 52.9% for the nine months ended September 30, 2007, compared to 49.2% for the nine months ended September 30, 2006. We experienced a net increase in professional compensation expense of \$114.2 million, or 9.0%, to \$1,378.2 million for the nine months ended September 30, 2007 over \$1,264.1 million for the nine months ended September 30, 2006. The increase in professional compensation expense was primarily due to increases in stock-based compensation expense for PSUs, RSUs, merit-based annual salary increases to our billable staff, as well as cash bonuses.

Other direct contract expenses decreased as a percentage of revenue to 22.9% for the nine months ended September 30, 2007 compared to 26.1% for the nine months ended September 30, 2006. We experienced a net decrease in other direct contract expenses of \$73.9 million, or 11.0%, to \$596.8 million for the nine months ended September 30, 2007 from \$670.7 million for the nine months ended September 30, 2006. The decrease was driven primarily by reduced subcontractor expenses as a result of increased use of internal resources. In addition, the decline was driven by higher other direct contract expenses recorded in the first quarter of 2006 related to the settlement of the HT contract.

Other costs of service as a percentage of revenue increased to 8.5% for the nine months ended September 30, 2007 over 7.0% for the nine months ended September 30, 2006. We experienced a net increase in other costs of service of \$41.3 million, or 23.0%, to \$221.0 million for the nine months ended September 30, 2007 over \$179.7 million for the nine months ended September 30, 2006. The increase was primarily due to increases in the number of non-billable employees, higher recruiting costs and a software impairment charge recorded within EMEA. The increase in the number of non-billable employees was due in part to the redeployment of

existing employees from client-facing roles to practice support roles, which results in related salaries and expenses now being reflected in other costs of service rather than professional expense.

During the nine months ended September 30, 2007 we recorded, within the Corporate/Other operating segment, a restructuring charge of \$0.3 million related to lease, facilities and other exit activities, compared with a \$6.2 million charge during the nine months ended September 30, 2006. These charges related primarily to the fair value of future lease obligations associated with office space that we will no longer be using, primarily within the EMEA and North America regions.

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Gross Profit by Segment. The following tables present certain gross profit and margin information and performance metrics for each of our reportable segments for the nine months ended September 30, 2007 and 2006. Amounts are in thousands, except percentages.

	Nine Months Ended September 30,			%
	2007	2006	\$ Change	Change
Gross Profit				
Public Services	\$ 219,505	\$ 206,985	\$ 12,520	6.0%
Commercial Services	78,309	50,169	28,140	56.1%
Financial Services	32,667	113,797	(81,130)	(71.3%)
EMEA	113,191	103,114	10,077	9.8%
Asia Pacific	61,015	66,638	(5,623)	(8.4%)
Latin America	(4,127)	5,267	(9,394)	n/m
Corporate/Other	(93,349)	(96,966)	3,617	n/m
Total	\$ 407,211	\$ 449,004	\$ (41,793)	(9.3%)

	Nine Months Ended September 30,	
	2007	2006
Gross Profit as a % of revenue		
Public Services	20.2%	20.6%
Commercial Services	19.5%	12.2%
Financial Services	15.6%	35.6%
EMEA	19.9%	20.6%
Asia Pacific	22.8%	24.5%
Latin America	(6.1%)	9.3%
Corporate/Other	n/m	n/m
Total	15.6%	17.5%

n/m = not meaningful

Changes in gross profit by segment were as follows:

Public Services gross profit increased in the nine months ended September 30, 2007, primarily due to revenue increases in our Emerging Markets, SLED and Civilian sectors combined with substantial improvement in gross profit in our SLED sector resulting from significant reductions in other direct contract expenses recorded in fiscal 2006 attributable to two completed contracts. This increase in revenue more than offset increases in professional compensation expense related primarily to costs associated with additional personnel to meet the demand for our services and, to a lesser extent, additional stock-based compensation expense attributable to PSUs and RSUs.

Commercial Services gross profit significantly increased in the nine months ended September 30, 2007. This increase was primarily due to the absence of losses recorded in the first quarter of 2006 attributable to the settlement of disputes with two significant telecommunications industry clients.

Financial Services gross profit significantly decreased in the nine months ended September 30, 2007, primarily due to significantly lower revenue in the first nine months of 2007 compared to the first nine months of 2006 as well as a decline in the mix of higher margin engagements. Despite a decrease in billable personnel,

compensation expense declined at a slower pace due to increases in stock-based compensation expense.

EMEA gross profit increased in the nine months ended September 30, 2007, primarily due to overall higher revenue in the EMEA region as well as improved profitability in Germany and Switzerland as a result of higher utilization and reduced costs.

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This increase was partially offset by an increase in professional compensation due to higher billable personnel, and to a lesser extent, an increase in other costs of services while other direct contract expenses remained relatively flat.

Asia Pacific gross profit decreased in the nine months ended September 30, 2007, due primarily to lower revenue recognized in that region and estimated accruals to resolve issues related to a previously completed client engagement.

Latin America gross profit decreased in the nine months ended September 30, 2007, as increases in compensation expense, driven by an increase in billable personnel to meet the growth of our business, primarily in Brazil, more than offset revenue growth in the region.

Corporate/Other consists primarily of rent expense and other facilities related charges, which decreased in the nine months ended September 30, 2007 primarily due to the lease and facilities restructuring charges discussed above.

Amortization of Purchased Intangible Assets. We did not incur any amortization expense in the nine months ended September 30, 2007, as our intangible assets were fully amortized. Amortization of purchased intangible assets was \$1.5 million in the nine months ended September 30, 2006.

Selling, General and Administrative Expenses. We incurred SG&A expenses of \$512.3 million for the nine months ended September 30, 2007, representing a decrease of \$26.3 million, or 4.9%, from SG&A expenses of \$538.6 million for the nine months ended September 30, 2006. SG&A expenses as a percentage of gross revenue decreased to 19.7% in the nine months ended September 30, 2007 from 21.0% for the nine months ended September 30, 2006. The decrease was primarily due to reduced costs directly related to the closing of our financial statements and subcontracted labor, as well as savings from the reduction in the size of our sales force and reducing other business development expenses. Partially offsetting these savings were increased compensation expense for additional SG&A personnel and stock-based compensation expense for PSUs and RSUs, and bonuses.

Interest Income. Interest income was \$7.5 million and \$6.1 million in the nine months ended September 30, 2007 and 2006, respectively. Interest income is earned primarily from cash and cash equivalents, including money-market investments. The increase in interest income was due to a higher level of cash available to be invested in money markets during the nine months ended September 30, 2007, as compared to the nine months ended September 30, 2006.

Interest Expense. Interest expense was \$44.2 million and \$26.6 million in the nine months ended September 30, 2007 and 2006, respectively. Interest expense is attributable to our debt obligations, consisting of interest due along with amortization of loan costs and loan discounts. The increase in interest expense was due to interest attributable to our 2007 Credit Facility entered into on May 18, 2007, the acceleration of debt issuance costs resulting from the termination of the 2005 Credit Facility, and, to a lesser extent, higher interest rates on our debt obligations.

Insurance Settlement. During the nine months ended September 30, 2006, we recorded \$38.0 million for an insurance settlement in connection with our settlement with HT. For more information, see Note 11, Commitments and Contingencies, of the Company's 2006 Form 10-K.

Other (Expense) Income, net. Other expense, net was \$5.7 million in the nine months ended September 30, 2007 compared to other income, net of \$2.9 million in the nine months ended September 30, 2006. The balances in each period primarily consist of unrealized foreign currency exchange losses and gains.

Income Tax Expense. We incurred income tax expense of \$46.2 million and \$34.4 million for the nine months ended September 30, 2007 and 2006, respectively. The principal reasons for the difference between the effective income tax rates on loss from continuing operations of (31.3%) and (48.7%) for the nine months ended September 30, 2007 and 2006, respectively, were: a change in valuation allowance; changes in income tax reserves; the mix of income attributable to foreign versus domestic jurisdictions; state and local taxes; other items and non-deductible meals and entertainment.

Net Loss. For the nine months ended September 30, 2007, we incurred a net loss of \$193.7 million, or a loss of \$0.90 per share. Contributing to the net loss for the nine months ended September 30, 2007 were stock-based

compensation expense and bonuses accrued for our employees.

For the nine months ended September 30, 2006, we incurred a net loss of \$105.2 million, or a loss of \$0.50 per share. Included in our results for the nine months ended September 30, 2006 were losses related to previously mentioned settlements with

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telecommunication clients, bonuses accrued for our employees, stock-based compensation expense and lease and facilities restructuring charges.

Liquidity and Capital Resources

The following table summarizes the cash flow statements for the nine months ended September 30, 2007 and 2006 (amounts are in thousands):

	Nine Months Ended September 30,		
	2007	2006	2006 to 2007 Change
Net cash provided by (used in):			
Operating activities	\$ (221,951)	\$ (74,524)	\$ (147,427)
Investing activities	(31,848)	87,799	(119,647)
Financing activities	282,156	(7,316)	289,472
Effect of exchange rate changes on cash and cash equivalents	10,203	7,600	2,603
Net increase in cash and cash equivalents	\$ 38,560	\$ 13,559	\$ 25,001

Operating Activities. Net cash used in operating activities during the nine months ended September 30, 2007 increased \$147.4 million over the nine months ended September 30, 2006. This increase was primarily attributable to significant increases to our combined accounts receivable and unbilled revenue, which resulted in an increase in DSOs since December 31, 2006, significant reductions in our accounts payable due to timing of vendor payments, settlement of certain legal matters, and to a lesser extent, an increase in net loss, net of non-cash items.

Investing Activities. Net cash used in investing activities during the nine months ended September 30, 2007 was \$31.8 million and net cash provided by investing activities during the nine months ended September 30, 2006 was \$87.8 million. Capital expenditures were \$31.8 million and \$30.3 million during the nine months ended September 30, 2007 and 2006, respectively. In the nine months ended September 30, 2006, \$118.1 million of restricted cash posted as collateral for letters of credit and surety bonds was released.

Financing Activities. Net cash provided by financing activities for the nine months ended September 30, 2007 was \$282.2 million, resulting primarily from the proceeds received from the Term Loans under the 2007 Credit Facility with an aggregate principal amount of \$300.0 million. Net cash used in financing activities for the nine months ended September 30, 2006 was \$7.3 million, mainly due to repayments of our Japanese term loans.

Additional Cash Flow Information

At September 30, 2007, we had global cash balances of \$431.2 million.

Our decision to obtain the 2007 Credit Facility was based, in part, on the fact that the North American cash balances had been negatively affected in the second quarter of 2007 by, among other things, cash collection levels not maintaining pace with the levels achieved in the fourth quarter of 2006 and payments made in connection with (1) the uninsured portion of the settlement of the dispute with HT, (2) ongoing costs relating to the design and implementation of the new North American financial reporting systems, (3) ongoing costs relating to production and completion of our financial statements, (4) other additional accrued expenses for 2006 paid in the second quarter of 2007, and (5) our expectations at the time that operations would not generate cash before the latter part of 2007.

We currently expect that our operations will provide a source of cash through the remainder of 2007. At September 30, 2007, our DSOs stood at 90 days. To generate significant amounts of cash from operations in the latter part of 2007, we must again exceed our cash collections for the fourth quarter of fiscal 2006 when our DSOs stood at 82 days.

Based on the foregoing and our current state of knowledge of the outlook for our business, we currently believe that our existing cash balances and cash flows expected to be generated from operations will be adequate to finance our working capital needs for the next twelve months. However, actual results may differ from current expectations for many reasons, including losses of business that could result from our continuing failure to timely file periodic

reports with the SEC, the occurrence of any event of default that could

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provide our lenders with a right of acceleration (e.g., non-payment), possible delisting from the New York Stock Exchange, further downgrades of our credit ratings or unexpected demands on our current cash resources (e.g., to settle lawsuits).

For additional information regarding various risk factors that could affect our outlook, see Item 1A, Risk Factors. If cash provided from operations is insufficient and/or our ability to access the capital markets is impeded, our business, operations, results and cash flow could be materially and adversely affected.

Recently Issued Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of SFAS 157 are effective beginning January 1, 2008. We are currently evaluating the impact of the provisions of SFAS 157.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of SFAS 115. SFAS 159 allows entities to choose, at specific election dates, to measure eligible financial assets and liabilities at fair value that are not otherwise required to be measured at fair value. If a company elects the fair value option for an eligible item, changes in that item's fair value in subsequent reporting periods must be recognized in current earnings. SFAS 159 is effective beginning January 1, 2008. We are currently evaluating the impact of the provisions of SFAS 159.

PART I, ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes as of September 30, 2007 to our market risk exposure disclosed in our 2006 Form 10-K. For a discussion of our market risk associated with the Company's market sensitive financial instruments as of December 31, 2006, see Quantitative and Qualitative Disclosures About Market Risk in Part II, Item 7A, of our 2006 Form 10-K.

PART I, ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

As of the end of the period covered by this Quarterly Report, management performed, with the participation of our Chief Executive Officer and our Chief Financial Officer, an evaluation of the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act. Our disclosure controls and procedures are designed to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, to allow timely decisions regarding required disclosures. Based on the evaluation and the identification as of September 30, 2007, of the material weaknesses in internal control over financial reporting, as previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2006, the Company's disclosure controls and procedures were not effective.

Because of the material weaknesses identified in our evaluation of internal control over financial reporting as of September 30, 2007, we performed additional substantive procedures, similar to those previously disclosed in Form 10-K for the year ended December 31, 2006, so that our consolidated condensed financial statements as of and for the three and nine month periods ended September 30, 2007, are fairly stated in all material respects in accordance with GAAP.

Our management, including the Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting during the most recently completed fiscal quarter that have materially affected or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Overview

We currently are a party to a number of disputes that involve or may involve litigation or other legal or regulatory proceedings. Generally, there are three types of legal proceedings to which we have been made a party:

Claims and investigations arising from our continuing inability to timely file periodic reports under the Exchange Act, and the restatement of our financial statements for certain prior periods to correct accounting errors and departures from generally accepted accounting principles for those years (SEC Reporting Matters);

Claims and investigations being conducted by agencies or officers of the U.S. Federal government and arising in connection with our provision of services under contracts with agencies of the U.S. Federal government (Government Contracting Matters); and

Claims made in the ordinary course of business by clients seeking damages for alleged breaches of contract or failure of performance, by current or former employees seeking damages for alleged acts of wrongful termination or discrimination, and by creditors or other vendors alleging defaults in payment or performance (Other Matters).

We currently maintain insurance in types and amounts customary in our industry, including coverage for professional liability, general liability and management and director liability. Based on management's current assessment and insurance coverages believed to be available, we believe that the Company's financial statements include adequate provision for estimated losses that are likely to be incurred with regard to all matters of the types described above.

The following describes legal proceedings as to which material developments have occurred in the period covered by this report, which matters have been previously disclosed in our 2006 Form 10-K and in our quarterly filings on Form 10-Q.

SEC Reporting Matters

2005 Class Action Suits. In and after April 2005, various separate complaints were filed in the U.S. District Court for the Eastern District of Virginia, alleging that the Company and certain of its current and former officers and directors violated Section 10(b) of the Exchange Act, Rule 10b-5 promulgated thereunder and Section 20(a) of the Exchange Act by, among other things, making materially misleading statements between August 14, 2003 and April 20, 2005 with respect to our financial results in our SEC filings and press releases. On January 17, 2006, the court certified a class, appointed class counsel and appointed a class representative. The plaintiffs filed an amended complaint on March 10, 2006 and the defendants, including the Company, subsequently filed a motion to dismiss that complaint, which was fully briefed and heard on May 5, 2006. We were awaiting a ruling when, on March 23, 2007, the court stayed the case, pending the U.S. Supreme Court's decision in the case of *Makor Issues & Rights, Ltd v. Tellabs*, argued before the Supreme Court on March 28, 2007. On June 21, 2007, the Supreme Court issued its opinion in the *Tellabs* case, holding that to plead a strong inference of a defendant's fraudulent intent under the applicable federal securities laws, a plaintiff must demonstrate that such an inference is not merely reasonable, but cogent and at least as compelling as any opposing inference of non-fraudulent intent. On September 12, 2007, the court dismissed with prejudice this complaint, granting motions to dismiss filed by the Company and the other named defendants. In granting the Company's motion to dismiss, the court ruled that the plaintiff failed to meet the scienter pleading requirements set forth in the Private Securities Litigation Reform Act of 1995, as amended. On September 26, 2007, the plaintiffs filed a motion that seeks a reversal of the court's order dismissing the case or an amendment to the court's order that would allow the plaintiffs to replead. The Company filed its brief on October 17, 2007 and although a hearing on the plaintiffs' motion was scheduled for November 16, 2007, the court canceled the hearing as not necessary. On November 19, 2007, the court issued an order denying the plaintiffs' motion to amend or alter the court's September 12, 2007 dismissal of this matter.

In addition to the matters described above and in Item 3, Legal Proceedings of the 2006 Form 10-K, we are involved in a number of other judicial and arbitration proceedings concerning matters arising in the ordinary course of

our business, which we do

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not expect that any of these matters, individually or in the aggregate, will have a material impact on our results of operations or financial condition.

ITEM 1A. RISK FACTORS

There have been no material changes to the Risk Factors included in our 2006 Form 10-K, except as described below and previously reported in our Quarterly Report on Form 10-Q for the three months ended March 31, 2007 filed on September 7, 2007 and our Quarterly Report on Form 10-Q for the three and six months ended June 30, 2007 filed on October 22, 2007.

We may be unable to file our annual report on Form 10-K for fiscal 2007 on time. Our continuing failure to timely file certain periodic reports with the SEC poses significant risks to our business, each of which could materially and adversely affect our financial condition and results of operations.

The process, training and systems issues related to financial accounting for our North American operations and the material weaknesses in our internal control over financial reporting continue to materially affect our financial condition and results of operations. So long as we are unable to resolve these issues and remediate these material weaknesses, we will be in jeopardy of being unable to timely file our periodic reports with the SEC as they come due, and it is likely that our financial condition and results of operations will continue to be materially and adversely affected. Furthermore, the longer the period of time before we become timely in our periodic filings with the SEC and/or the number of subsequent failures to timely file any future periodic reports with the SEC could increase the likelihood or frequency of occurrence and severity of the impact of any of the risks described in Item 1A, Risk Factors of the 2006 Form 10-K.

The price of our common stock may decline due to the number of shares that may be available for sale in the future.

We have issued shares sold under our ESPP and will be delivering shares in settlement of previously vested RSUs.

Our ability to counter the market impact of share sales by our employees is limited. Our 2007 Credit Facility significantly restricts our ability to repurchase our shares, whether in the open market or from our employees in consideration of the payment of withholding taxes payable by them on the delivery of shares in settlement of RSUs. We cannot defer delivery of shares previously scheduled for settlement pursuant to RSUs beyond December 31, 2007 without risk of increasing the taxes that could be paid by recipients of those shares in the United States.

Under the terms of the RSUs, we have limited rights to defer settlement and the right to designate when recipients of shares under the RSUs may sell those shares. We intend to exercise those rights. However, the delivery of shares in settlement of these RSUs is generally a taxable event to our employees and we will not limit sales of these shares in such a way as to preclude recipients from being able to generate the funds from sales necessary to cover their withholding tax liabilities. Subject to these concerns and constraints, we intend to begin settling vested RSUs after the filing with the SEC of this Quarterly Report. It is our objective to release for sale, after each filing of a periodic report with the SEC, shares our employees are entitled to in amounts that are less than the current weighted average weekly trading volume of our shares. While we hope that this proposed delivery schedule will facilitate the orderly sale of shares by our employees into the markets, the timing and amounts of sales by our employees will remain within their control.

For additional risk factors, see Item 1A, Risk Factors, to the 2006 Form 10-K and the Quarterly Reports on Form 10-Q for the quarter ended March 31, 2007 and June 30, 2007.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On August 16, 2007, we issued 563,474 shares of our common stock to the former stockholders of Softline in fulfillment of our obligations pursuant to the Company's acquisition of Softline. The shares were issued pursuant to the exemption from registration provided by Section 4(2) of the Securities Act of 1933, as amended. For additional information, see Note 9, Commitments and Contingencies Other Matters Softline Acquisition Obligation, of the Notes to Consolidated Condensed Financial Statements.

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None.

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

There were no matters submitted to a vote of security holders during the three months ended September 30, 2007.

On November 5, 2007, the Company held its 2007 Annual Meeting of Stockholders. Set forth below is information concerning each matter submitted to a vote at the meeting.

- (1) Election of Directors. The stockholders elected the following persons as Class I directors to hold office until the annual meeting of stockholders to be held in 2010 and their respective successors have been duly elected and qualified.

Nominee for Class I Director	For	Withhold
Douglas C. Allred	152,960,864	28,469,643
Betsy J. Bernard	153,017,163	28,413,344
Spencer C. Fleischer	179,134,849	2,295,658

The following directors also continued in office after the 2007 Annual Meeting of Stockholders: Jill S.

Kanin-Lovers, Wolfgang Kemna, Albert L. Lord, Roderick C. McGeary, Eddie R. Munson, J. Terry Strange and Harry L. You. For additional information, see Item 5 Other Information.

- (2) Ratification of Appointment of Ernst & Young LLP. The stockholders ratified the appointment of Ernst & Young LLP as the Company's independent registered public accounting firm for the Company's 2007 fiscal year.

For	Against	Abstain
178,240,625	567,529	2,622,353

ITEM 5. OTHER INFORMATION

On December 3, 2007, the Company announced that, effective December 3, 2007, it had named Ed Harbach, the Company's current President and Chief Operating Officer, as its new Chief Executive Officer. Mr. Harbach was also appointed to the Company's Board of Directors. Mr. Harbach succeeds Harry You, who tendered his resignation on December 3, 2007. Mr. You has held those positions since 2004.

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ITEM 6. EXHIBITS

Exhibit

No.	Description
3.1	Amended and Restated Certificate of Incorporation, dated as of February 7, 2001, which is incorporated herein by reference to Exhibit 3.1 from the Company's Form 10-Q for the quarter ended March 31, 2001.
3.2	Amended and Restated Bylaws, amended and restated as of August 2, 2007, which is incorporated herein by reference to Exhibit 3.1 from the Company's Form 8-K filed with the SEC on August 8, 2007.
3.3	Certificate of Ownership and Merger merging Bones Holding into the Company, dated October 2, 2002, which is incorporated herein by reference to Exhibit 3.3 from the Company's Form 10-Q for the quarter ended September 30, 2002.
4.1	Rights Agreement, dated as of October 2, 2001, between the Company and Computershare Trust Company, N.A. (formerly EquiServe Trust Company, N.A.), which is incorporated herein by reference to Exhibit 1.1 from the Company's Registration Statement on Form 8-A dated October 3, 2001.
4.2	Certificate of Designation of Series A Junior Participating Preferred Stock, which is incorporated herein by reference to Exhibit 1.2 from the Company's Registration Statement on Form 8-A dated October 3, 2001.
4.3	First Amendment to the Rights Agreement between the Company and Computershare Trust Company, N.A. (formerly EquiServe Trust Company, N.A.), which is incorporated herein by reference to Exhibit 99.1 from the Company's Form 8-K filed with the SEC on September 6, 2002.
4.4	Second Amendment to the Rights Agreement between the Company and Computershare Trust Company, N.A. (formerly EquiServe Trust Company, N.A.), which is incorporated herein by reference to Exhibit 4.4 from the Company's Form 10-Q for the quarter ended June 30, 2007.
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or 15d-14(a).
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or 15d-14(a).
32.1	Certification of Chief Executive Officer pursuant to Section 1350.
32.2	Certification of Chief Financial Officer pursuant to Section 1350.

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SIGNATURES

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

Bearingpoint, Inc.

DATE: December 3, 2007

By: /s/ Judy A. Ethell
Judy A. Ethell
Chief Financial Officer