EXPONENT INC
Form 10-K
March 06, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 30, 2005.

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 0-18655

EXPONENT, INC.

(Exact name of registrant as specified in its charter)

Delaware	**77-0218904**
(State or other jurisdiction of incorporation or organization)	**(IRS employer identification no.)**

149 Commonwealth Drive, Menlo Park, California 94025

(Address of principal executive offices, including zip code)

Registrant s telephone number, including area code: (650) 326-9400

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, $.001 par value

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ¨ No x

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Act).

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

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

The aggregate market value of the voting stock held by non-affiliates of the registrant based on the closing sales price of the Common Stock as reported on the NASDAQ National Market on July 1, 2005, the last business day of the registrant s most recently completed second quarter, was $191,434,111. Shares of the registrant s common stock held by each executive officer and director and by each entity or person that, to the registrant s knowledge, owned 10% or more of registrant s outstanding common stock as of July 1, 2005 have been excluded in that such persons may be deemed to be affiliates of the registrant. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares of the issuer s Common Stock outstanding as of February 24, 2006 was 8,178,843.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant s definitive Proxy Statement for the Registrant s 2006 Annual Meeting of Stockholders to be held on May 24, 2006, are incorporated by reference into Part III of this Form 10-K.

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EXPONENT, INC.

FORM 10-K ANNUAL REPORT

FISCAL YEAR ENDED DECEMBER 30, 2005

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FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains, and incorporates by reference, certain forward-looking statements (as such term is defined in the Private Securities Litigation Reform Act of 1995, and the rules promulgated pursuant to the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended thereto under) that are based on the beliefs of the Company s management, as well as assumptions made by, and information currently available to, the Company s management. Such forward-looking statements are subject to the safe harbor created by the Private Securities Litigation Reform Act of 1995. When used in this document and in the documents incorporated herein by reference, statements other than statements of

historical fact are forward-looking statements. The words anticipate, believe, estimate, expect and similar expressions, as they relate to the Company or its management, identify certain of such forward-looking statements. Such statements reflect the current views of the Company or its management with respect to future events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, the Company s actual results, performance, or achievements could differ materially from those expressed in, or implied by, any such forward-looking statements. Factors that could cause or contribute to such material differences include the possibility that the demand for our services may decline as a result of changes in general and industry

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specific economic conditions, the timing of engagements for our services, the effects of competitive services and pricing, and liabilities resulting from claims made against us. Additional risks and uncertainties are discussed in this Report under the heading Risk Factors and elsewhere. The inclusion of such forward-looking information should not be regarded as a representation by the Company or any other person that the future events, plans, or expectations contemplated by the Company will be achieved. The Company undertakes no obligation to release publicly any updates or revisions to any such forward-looking statements.

PART I

Item 1. Business

GENERAL

The inception of Exponent, Inc. goes back to 1967, with the founding of the partnership Failure Analysis Associates, which was incorporated the following year in California and reincorporated in Delaware as Failure Analysis Associates, Inc. in 1988. The Failure Group, Inc. was organized in 1989 as a holding company for Failure Analysis Associates, Inc. and changed its name to Exponent, Inc. in 1998. Exponent, Inc. (together with its subsidiaries, Exponent or the Company), is a science and engineering consulting firm that provides solutions to complex problems. Our multidisciplinary team of scientists, physicians, engineers, business and regulatory consultants brings together more than 70 different technical disciplines to solve complicated issues facing industry and government today. Our professional staff can perform in-depth scientific research and analysis, or very rapid-response evaluations to provide our clients with the critical information they need.

CLIENTS

General

Exponent serves clients in automotive, aviation, chemical, construction, consumer products, energy, government, health, insurance, manufacturing, technology and other sectors of the economy. Many of our engagements are initiated directly with large corporations or by lawyers or insurance companies, whose clients anticipate, or are engaged in, litigation over an alleged failure of their products, equipment or service. Our services in failure prevention and technology evaluation have grown as the technological complexity of products has increased over the years.

Pricing and Terms of Engagements

We provide our services on either a fixed-price basis or on a time and expenses basis, charging hourly rates for each staff member involved in a project, based on his or her skills and experience. Our standard rates for professionals range from $90 to $800 per hour. Our engagement agreements typically provide for monthly billing, require payment of our invoices within 30 days of receipt and permit clients to terminate engagements at any time. Clients normally agree to indemnify us and our personnel against liabilities arising out of the use or application of the results of our work or recommendations.

SERVICES

Exponent s service offerings are provided on a project-by-project basis. Many projects require support from multiple practices. We currently operate 15 practices, including:

Biomechanics

Civil Engineering

Construction Consulting

Data/Risk Analysis

EcoSciences

Electrical Engineering

Environmental Sciences

Food & Chemicals

Health Sciences

Human Factors

Industrial Structures

Mechanical Engineering & Materials Science

Technology Development

Thermal Sciences

Vehicle Analysis

Biomechanics

Exponent s Biomechanics staff use engineering and biomedical science to explore the cause, nature and severity of injuries. The type and distribution of injuries, combined with our extensive experience in human injury tolerance, allows us to determine the forces and motions that must have occurred to produce the injuries. Through close interaction with our Vehicle Analysis and Human Factors practices, our consultants analyze the human s overall role in an accident, including assessments of the likelihood, causation and severity of the accident.

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In 2005, our staff published more than 50 significant articles related to injury mechanics in motor vehicle accidents, medical devices and biotechnology. We assisted several clients with patent infringement support work and provided independent third-party evaluations on new products. In addition, we provided consulting support in litigation involving personal injury and product defect allegations. For example, we were engaged to investigate an incident involving an equipment operator who fell into a cooling pit containing water at a temperature of approximately 150° F. The equipment operator pulled himself out and sought help, but ultimately died of second and third degree burns to over 95% of his body. There were no witnesses, but it was alleged that the platform from which he operated was improperly guarded, causing the incident. The analysis performed by our Biomechanics practice showed that the incident could not have occurred the way the plaintiffs contend and that the deceased did not fall from the platform. Our opinions were illustrated by three animations produced by Exponent s Visual Communication group.

Civil Engineering

Exponent has over 25 years experience investigating all types of structural, geotechnical, hydrological, construction and building problems, from major catastrophes to simple performance failures. Our rigorous technical analysis of these problems provides our clients with a thorough assessment of damage, as well as expert analysis of causation to be used for purposes of retrofit, repair, claims adjustment, or litigation. In addition, we use our expertise to help clients avoid failures with services such as vulnerability assessments of their facilities, development of appropriate mitigation measures, and development of solutions to challenging development and design problems.

In the immediate aftermath of Hurricane Katrina, engineers from Exponent s Civil practice deployed to New Orleans as part of the Federal Emergency Management Agency s Urban Search and Rescue operations. Following completion of rescue operations, and working with scientists from our Health Sciences practice, the Civil practice has been assisting commercial, industrial and insurance clients with failure investigations and damage assessments at more than five hundred land-based and offshore sites in Louisiana, Mississippi and Alabama.

Construction Consulting

Exponent s Construction Consulting practice provides construction management services to clients through all phases of the project life cycle, and, if necessary, through dispute resolution. Exponent s engineers, cost accountants, architects, scientists and technical specialists provide these services to both the public and private sectors, supporting our client s project staff through all phases of the design and construction process. Our staff identifies and evaluates construction processes and issues related to scope changes, schedule delays, production disruption and inefficiency, as well as the costs associated with these types of issues. They also identify the risks associated with large-scale, complex construction projects and take proactive measures to avoid potential obstacles.

In 2005, Exponent s Construction Consulting practice experienced significant growth both in revenue, staff and clients. Projects range from standard dispute resolution services to a major investigation of a large financial institution s real-estate construction group, involving the analysis of more than a dozen projects with total capital expenditures of approximately $800 million. The construction consulting practice added staff in Oakland and Los Angeles. In addition, our Washington D.C. practice continued to grow throughout 2005, and our New York staff, which joined in mid-2004, have contributed significantly to the year s revenue growth.

Data/Risk Analysis

All living humans continually bear a certain degree of risk of injury or death. Exponent s Data/Risk Analysis practice specializes in determining whether a particular activity or product poses an unreasonable risk. Risk estimation involves establishing a reference period and then collecting information about the number of injuries (or other adverse events) suffered and the amount of exposure during this period. For example, one of the practice s 2005 engagements involved a motor vehicle manufacturer who received complaints alleging that a vehicle took off or accelerated without warning. The vehicle in question was produced in high volume over several years. Exponent analyzed data from state databases of traffic crashes, which showed that the risk of sudden acceleration for the subject vehicle was not unusual when compared to other passenger vehicles.

To support a diverse array of empirical research studies, extending well beyond traditional risk analysis, the Data/Risk Analysis practice also offers clients general statistical consulting services. Exponent statisticians, programmers and analysts apply their expertise in data collection, description, analysis and interpretation for clients at any and all stages of a study. For example, we designed a

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reliability test to determine the stress level at which a battery will produce an adverse response with small, but non-negligible, probability. Applying a method developed in health risk assessment for low-dose extrapolation, our approach used test resources more efficiently and yielded more accurate estimates than traditional test designs.

EcoSciences

Exponent s ecological scientists provide proven, cost-effective and scientifically defensible solutions to complex issues. State and federal trustees are pursuing natural resource damage claims more aggressively than in the past. Natural resource damages are a corporate environmental liability beyond cleanup or response actions. Damage claims can be very large, and settlement or litigation costs correspondingly high. Exponent assists clients in optimizing costs associated with claims for damages to natural resources, while still protecting the environment.

For example, Exponent recently completed an independent evaluation of the technical work that has been done to date in assessing ecological impacts from use of seawater in open loop vaporization (OLV) systems proposed in Liquefied Natural Gas (LNG) terminals in the Gulf of Mexico. The study was commissioned by The Center for Liquefied Natural Gas. The primary environmental question associated with the use of OLV technology is the potential for impact on fish eggs and larvae into seawater intakes. Exponent found the Environmental Impact Statement assessments contained numerous conservative assumptions that significantly over-estimated the potential for adverse impacts from offshore LNG projects.

Electrical Engineering

In the age of electronics, Exponent continues to be a highly sought-after resource for understanding current and potential risks involving electrical and electronic components. Our team of electrical engineers performs a wide array of investigations ranging from electric power systems to semiconductor devices. We operate laboratories for testing both heavy equipment and light electronic equipment, and use computers and specialized software to analyze electric power systems, circuits and other equipment configurations.

For example, Exponent is currently working both in the U.S., and in our new office in China, with several electronics manufacturers to critically evaluate pre-production products as an independent third party. This role in the safety evaluation of clients pre-production

products is important in minimizing risk and product recalls. These clients require an Exponent product safety evaluation report before the product can be released to the market. Products are evaluated based on the client s safety specifications and also Exponent s expertise in the field. We also operate a specialized laboratory in Phoenix for safety assessment of lithium ion and other battery storage systems.

Environmental Sciences

Exponent s environmental scientists and engineers provide proven, cost-effective, scientifically defensible and realistic assessments and solutions to complex environmental issues. We offer technical, regulatory and litigation support to industries that include mining and minerals, petrochemicals, forest products, shipbuilding, railroads, aerospace, and defense and trade associations. Our consultants also address hydrological issues related to new housing and office complex developments around the country.

Our experts in environmental forensics (the identification and allocation of sources of contaminants, estimation of timing of releases and dose reconstruction) are widely respected for their technical knowledge and ability to communicate complex issues to the public or a courtroom audience. For example, we recently completed an evaluation of the sources of dioxins, polycyclic aromatic hydrocarbons and arsenic in a residential community near a wood treatment site in connection with a major toxic tort litigation. This comprehensive analysis utilized sophisticated analytical chemistry knowledge, geostatistics, multivariate statistics and an understanding of the physics of air dispersion and surface water transport. Our analysis found that the alleged contamination occurred at typical background levels and that some of the variability in dioxin and arsenic concentrations was due to historic open burning of trash and use of rat poison, respectively.

Food & Chemicals

Our Food and Chemicals practice includes experienced staff of both technical and regulatory specialists who are experienced in dealing with foods, and with pesticide and non-pesticide products including conventional chemicals, biochemicals, microbials and products of biotechnology. We provide practical, creative, scientific and regulatory support to meet global business objectives at every stage of the product cycle, from R&D to retail.

Our Food and Chemicals practice has worked with a number of European biocides manufacturers to evaluate data, produce data waiver argumentation,

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conduct human and environmental risk assessments, and produce summary dossiers of data that are required for ongoing regulatory review in Europe. Following dossier submission, we have also assisted clients in responding to issues raised by European Union regulators, where we have successfully defended our clients products and regulatory strategies, often using innovative but scientifically defensible approaches, resulting in the minimization of additional data requirements and costs for our clients.

Health Sciences

Exponent s Health Sciences practice specializes in solving complex health problems that require an experienced team of multidisciplined health professionals. Our epidemiologists, physicians, toxicologists, statisticians, industrial hygienists and other health care professionals apply innovative techniques to help clients address a variety of issues. These include environmental and occupational epidemiology, pharmacoepidemiology, industrial hygiene, emergency response and risk assessment. Exponent applies sophisticated approaches in study design, statistical analysis, exposure assessment and medical causation to examine a variety of health issues.

Hurricane Katrina resulted in severe structural and product damage, as well as causing critical health related issues for people living in the affected area. Food products such as coffee stored in warehouses were subjected to flooding by contaminated floodwaters. Members of Exponent s Health Sciences practice were retained to evaluate risk to human consumption of some of these food products. At stake is hundreds of millions of dollars of food products that were potentially either directly or indirectly impacted. Exponent consultants conducted site investigations, collected samples for laboratory analysis, and did human risk assessments as to potential health impacts from both chemical and microbiological contamination to these food products. This work was in addition to the work that we were already performing related to toxic affects of mold that resulted from the hurricane.

Human Factors

Our Human Factors practice analyzes human cognition and behavior to guide product design decisions to provide better product safety and usability. Working in conjunction with other Exponent practices, our scientists look at ways to improve product design, as well as review safety information and training to help change human behavior and reduce accidents.

Recently, the Human Factors practice developed a technique to validate the accuracy of digital photographs that are used to represent an accident scene where the amount of lighting determines whether or not a critical feature of the scene is visible. Photographs taken of a scene at night do not always accurately replicate the scene as it appeared to a person present at that scene. When an accident occurs and questions arise about the visibility of objects that were present at the accident site, it is important that later photographs taken of the scene accurately represent what people might have been able to observe. The technique we developed allows us to accurately depict the scene in terms of the illumination and conspicuity of objects. Our results indicate that the resultant photographs are, in fact, representative of what an average, naïve viewer would observe at the scene. The results of this study will be presented at the 2006 Society of Automotive Engineers (SAE) World Congress. In addition, the groundwork was laid for future work in 2006 to implement this method on-site, so that consultants can obtain and adjust their photographs while at an inspection location to account for low-lighting conditions.

Industrial Structures

Our Industrial Structures practice, based in Düsseldorf, Germany, specializes in design and assessment of industrial concrete structures subject to extreme conditions. Exponent s Düsseldorf office has provided design reviews and assessments on more than 800 structures around the world, and our staff has participated in the creation of several engineering standards.

Mechanical Engineering and Materials Science

Our mechanical engineers and materials scientists have both an academic and real-world understanding of their field, including reliability and hazard evaluation, design assessment and materials life prediction. We routinely work with manufacturers to assess risks to their products during their design and manufacturing phases of product development. In addition, we help manufacturers analyze allegations of defective design by the federal regulatory agencies such as the Consumer Product Safety Commission.

In 2005, a multidisciplinary task force consisting of consultants from our Mechanical Engineering and Materials Science, Thermal Sciences and Electrical Engineering practices was formed to assess issues related to battery design, manufacturing and performance. Batteries of various chemistries,

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capacities and form factors appear in an increasing variety of products, including consumer electronics (laptop computers, cellular telephones, PDA s, digital cameras, MP3 players, mini DVD players), personal care products, medical devices, power tools, industrial appliances, backup power supplies, automotive products and aerospace products, among others. On occasion, the batteries in these products fail, leading to performance or safety concerns, including reduced capacity, overheating, case rupture and even flaming combustion.

By using a multidisciplinary approach involving staff from a wide range of disciplines, we are able to provide independent third party consulting services to battery and component manufacturers and suppliers. These services cover the entire field of portable power: basic electrochemistry and cell design fundamentals, cell manufacturing and quality control, battery pack design evaluation and testing, regulatory compliance, failure analysis and disposal/recycling issues.

Technology Development

Drawing on our multidisciplinary engineering, testing and failure analysis and prevention expertise, our Technology Development practice specializes in harnessing commercial technologies to develop effective military equipment and systems. In 2005, we continued to support the U.S. Army s efforts in Afghanistan and Iraq. In the field, our engineers are assisting the Rapid Equipping Force develop technical solutions related to combat issues.

The MARCBOT is a robotic system developed to combat the threat of Improvised Explosive Devices (IEDs). IEDs are claimed to be the number one threat for soldiers deployed in Afghanistan and Iraq. Exponent developed this system over the course of 18 months and four design spirals. To date, over 300 MARCBOT systems have been delivered to the U.S. Army Rapid Equipping Force for deployment in Operation Iraqi Freedom and Operation Enduring Freedom. Soldiers performing IED sweeps use this remote observation platform to inspect suspicious objects from a distance instead of walking or driving near the objects. Designed to be small enough and mobile enough for a platoon or squad-size element, the MARCBOT has met with high soldier acceptance and has been very effective in the fight against IEDs.

Thermal Sciences

Exponent has investigated and analyzed thousands of fires and explosions ranging from high loss disasters at manufacturing facilities to small insurance claims. Information gained from these analyses has helped us assist clients in assessing preventative measures related to the design of their products.

In 2005, Exponent was retained by the Fire Department, City of New York (FDNY) to provide independent third party engineering consulting and technical review services related to the FDNY s design and procurement of Personal Safety System s (PSS s) for use by its members. A PSS is a system of components intended to provide a firefighter with the means for self-rescue, and is to be carried by all members at all times when performing operations. Exponent was asked to review the design of the PSS and the FDNY s evaluation and testing process for selecting components. Exponent was also asked to verify the selected components compliance with applicable industry standards, including those published by the National Fire Protection Association as well as internal specifications published by the FDNY. Exponent analyzed and assessed the FDNY s component selection and evaluation efforts to ensure the PSS met the FDNY s requirements, and that the PSS was a suitable and efficient means to egress from a structure if conditions become untenable.

Vehicle Analysis

Our Vehicle Analysis practice provides design analysis, vehicle crash testing, component testing and accident reconstruction services to clients developing new automotive products, facing unexpected performance issues, or seeking information on how an accident occurred. At our 147-acre Test and Engineering Center in Phoenix, Arizona, we develop unique test protocols using proprietary tests developed by our consulting staff.

Exponent s Vehicle practice has had a long-term working relationship with a local Phoenix company that is sub-contracted by the U.S. Department of Energy to test the latest hybrid-electric vehicles to enter the consumer market, as well as neighborhood electric vehicles and recent developments in alternative fuel vehicles, such as experimental compressed hydrogen internal combustion engine platforms. Exponent has conducted handling testing, Environmental Protection Agency (EPA) fuel economy testing and battery performance testing on this class of vehicles. In addition, Exponent has co-authored an SAE paper titled Hybrid Electric Vehicle Fleet and Baseline Performance Testing, which presents EPA published fuel economy values alongside Exponent laboratory testing and real-world, long-term fleet testing. The paper will be presented at the April 2006 SAE conference.

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COMPETITION

The marketplace for our services is fragmented and we face different sources of competition in providing various services. In addition, the services that we provide to some of our clients can be performed in-house by those clients. However, because of liability and independence concerns, clients that have the capability to perform such services themselves often retain Exponent or other independent consultants.

In each of the foregoing practices, we believe that the principal competitive factors are: technical capability and breadth of services, ability to deliver services on a timely basis, professional reputation and knowledge of the litigation process. Although we believe that we generally compete favorably in each of these areas, some of our competitors may be able to provide services acceptable to our clients at lower prices.

We believe that the barriers to entry in particular areas of engineering expertise are low and that for many of our technical disciplines, competition is increasing. In response to competitive forces in the marketplace, we continue to explore new markets for our various technical disciplines.

EMPLOYEES

As of December 30, 2005, we employed 785 full-time and part-time employees, including 507 engineering and scientific staff, 110 technical support staff and 168 administrative and support staff. Our staff includes 419 employees with advanced degrees, of which 247 employees have achieved the level of Ph.D. or M.D.

ADDITIONAL INFORMATION

The address of our internet website is www.exponent.com. We make available, free of charge through our website, access to our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and other periodic SEC reports, along with amendments to all of those reports, as soon as reasonably practicable after we file the reports with the SEC.

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EXECUTIVE OFFICERS

The executive officers of Exponent and their ages as of March 6, 2006 are as follows:

Name	Age	Position
Michael R. Gaulke	60	President, Chief Executive Officer and Director
Roger L. McCarthy, Ph.D.	57	Chairman Emeritus and Director
Larry W. Anderson, Ph.D.	66	Group Vice President
Paul D. Boehm, Ph.D.	57	Group Vice President
Robert D. Caligiuri, Ph.D.	54	Group Vice President
Paul R. Johnston, Ph.D.	52	Chief Operating Officer
Subbaiah V. Malladi, Ph.D.	59	Chief Technical Officer
John E. Moalli, Sc.D.	41	Group Vice President
Richard L. Schlenker, Jr.	40	Chief Financial Officer and Corporate Secretary

Executive officers of Exponent are appointed by the Board of Directors and serve at the discretion of the Board or until the appointment of their successors. There is no family relationship between any of the directors and officers of the Company.

Michael R. Gaulke joined the Company in September 1992, as Executive Vice President and Chief Financial Officer. He was named President in March 1993 and he was appointed as a member of the Board of Directors of the Company in January 1994. He assumed his current role of President and Chief Executive Officer in June 1996. From November 1988 to September 1992, Mr. Gaulke served as Executive Vice President and Chief Financial Officer at Raynet Corporation, a subsidiary of Raychem Corporation. Prior to joining Raynet, Mr. Gaulke was Executive Vice President and Chief Financial Officer of Spectra Physics, Inc., where he was employed from 1979 to 1988. From 1972 to 1979, Mr. Gaulke served as a consultant with McKinsey & Company. Mr. Gaulke is a member of the Board of Directors of Cymer, Inc. and LECG Corporation and serves on the Board of Trustees of the Palo Alto Medical Foundation. Mr. Gaulke received an M.B.A. (1972) in Marketing and Operations from the Stanford University Graduate School of Business and a B.S. (1968) in Electrical Engineering from Oregon State University.

Roger L. McCarthy, Ph.D., joined the Company in August 1978. Currently, Dr. McCarthy is Chairman Emeritus of the Board of Directors and has been a Director of the Company since 1980. Dr. McCarthy served as Chairman of the Board of Directors from 1986 to May 2005. From June 1996 to October 1998, he served as Chief Technical Officer of the Company. He was Chief Executive Officer of the Company from 1982 to June 1996. He also served as President of the Company from 1982 to March 1993. Dr. McCarthy received his Ph.D. (1977), Mech.E. (1975) and S.M. (1973) from the Massachusetts Institute of Technology and his B.S.E. (1972) in Mechanical Engineering and A.B. (1972) in Philosophy from the University of Michigan. Dr. McCarthy is a Registered Professional Engineer in the states of California, Georgia, Ohio and Arizona and a member of the National Academy of Engineering.

Larry W. Anderson, Ph.D., joined the Company in 1986. He was promoted to Principal Engineer in 1993 and Group Vice President in 1996. Dr. Anderson received his Ph.D. (1966), M.S. (1964) and B.S. (1961) in Mechanical Engineering from the University of Washington. He is a Registered Professional Mechanical Engineer in the State of California.

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Paul D. Boehm, Ph.D., joined the Company in April 2004 as a Group Vice President. Prior to joining the Company, Dr. Boehm was Vice President and Market Manager, Oil and Gas Sector, at Battelle Memorial Institute from 2001 to 2004. From 1999 to 2001, Dr. Boehm was Vice President and Managing Director, Environmental Health and Safety Consulting at Arthur D. Little, Inc. Dr. Boehm received his Ph.D. (1977) and M.S. (1973) in Oceanography from the University of Rhode Island and B.S. (1970) in Chemical Engineering from the University of Rochester. Dr. Boehm has published more than 100 articles in peer-reviewed journals and authored numerous reports on environmental forensics and impact assessments. Dr. Boehm has been chosen to serve on several National Research Council panels.

Robert D. Caligiuri, Ph.D., joined the Company in 1987. He was promoted to Principal Engineer in 1990 and Group Vice President in 1999. Dr. Caligiuri received his Ph.D. (1977) and M.S. (1974) in Materials Science and Engineering from Stanford University and B.S. (1973) in Mechanical Engineering from the University of California, Davis. Prior to joining the Company he was a Program Manager and Materials Scientist for SRI International. He is a Registered Professional Metallurgical Engineer in the State of California, a Licensed Professional Engineer in the State of Utah and is a Fellow of the American Society for Materials.

Paul R. Johnston, Ph.D., joined the Company in 1981, was promoted to Vice President in 1997 and appointed Chief Operating Officer in July 2003. He received his Ph.D. (1981) in Civil Engineering and M.S. (1977) in Structural Engineering from Stanford University, and his B.A.I. (1976) in Civil Engineering and B.A. (1976) in Mathematics from Trinity College, University of Dublin, Ireland. Dr. Johnston is a Registered Professional Engineer in the State of California and a Chartered Engineer in Ireland.

Subbaiah V. Malladi, Ph.D., joined the Company in 1982 as a Senior Engineer, becoming a Senior Vice President in January 1988 and a Corporate Vice President in September 1993. In October 1998, Dr. Malladi was appointed Chief Technical Officer of the Company. Dr. Malladi also served as a Director of the Company from March 1991 through September 1993. He was re-appointed as a Director in April 1996 and served on the Board until May 2005. He received a Ph.D. (1980) in Mechanical Engineering from the California Institute of Technology, M.Tech (1972) in Mechanical Engineering from the Indian Institute of Technology, B.E. (1970) in Mechanical Engineering from SRI Venkateswara University, India and B.S. (1966) in Physics, Chemistry and Mathematics from Osmania University, India. Dr. Malladi is a Registered Professional Mechanical Engineer in the State of California.

John E. Moalli, Sc.D., joined the Company in 1992. He was promoted to Principal Engineer in 1997 and Group Vice President in 2002. Dr. Moalli received his Sc.D. (1992) in Polymers from the Massachusetts Institute of Technology and B.S. (1987) in Civil Engineering from Northeastern University. He is a member of the Society for the Plastics Industry, Society for Plastics Engineers and a member of the Editorial Advisory Board of Medical Plastics and Biomaterials.

Richard L. Schlenker, Jr. joined the Company in 1990. Mr. Schlenker is the Chief Financial Officer and Corporate Secretary of the Company. He was appointed Chief Financial Officer in July 1999 and was appointed Secretary of the Company in November 1997. Mr. Schlenker was the Director of Human Resources from 1998 until his appointment as CFO. He was the Manager of Corporate Development from 1996 until 1998. From 1993 to 1996, Mr. Schlenker was a Business Manager, where he managed the business activities for multiple consulting practices within the Company. Prior to 1993 he held several different positions in finance and accounting within the Company. Mr. Schlenker holds a B.S. in Finance from the University of Southern California.

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Item 1A. Risk Factors

Exponent operates in a rapidly changing environment that involves a number of uncertainties, some of which are beyond our control. These uncertainties include, but are not limited to, those mentioned elsewhere in this report and the following:

Absence of Backlog

Revenues are primarily derived from services provided in response to client requests or events that occur without notice, and engagements, generally billed as services are performed, are terminable or subject to postponement or delay at any time by clients. As a result, backlog at any particular time is small in relation to our quarterly or annual revenues and is not a reliable indicator of revenues for any future periods. Revenues and operating margins for any particular quarter are generally affected by staffing mix, resource requirements and timing and size of engagements.

Attraction and Retention of Key Employees

Exponent s business involves the delivery of professional services and is labor-intensive. Our success depends in large part upon our ability to attract, retain and motivate highly qualified technical and managerial personnel. Qualified personnel are in great demand and are likely to remain a limited resource for the foreseeable future. We cannot provide any assurance that we can continue to attract sufficient numbers of highly qualified technical and managerial personnel and to retain existing employees. The loss of key managerial employees or any significant number of employees could have a material adverse impact on our business, including our ability to secure and complete engagements.

Competition

The markets for our services are highly competitive. In addition, there are relatively low barriers to entry into our markets and we have faced, and expect to continue to face, additional competition from new entrants into our markets. Competitive pressure could reduce the market acceptance of our services and result in price reductions that could have a material adverse effect on our business, financial condition or results of operations.

Customer Concentration

We currently derive and believe that we will continue to derive a significant portion of our revenues from clients, organizations and insurers related to the transportation industry. Transportation industry related engagements accounted for approximately 20% of our revenues for the fiscal year ended

December 30, 2005. In addition, we performed engagements for the government sector, which accounted for approximately 11% of our revenues for the fiscal year ended December 30, 2005. The loss of any large client, organization or insurer related to either the transportation industry or government sector could have a material adverse effect on our business, financial condition or results of operations.

Economic Uncertainty

The markets that we serve are cyclical and subject to general economic conditions, particularly in light of the labor-intensive nature of our business and our relatively high compensation expenses. If the economy in which we operate, which is predominately in the U.S., were to experience a prolonged slowdown, demand for our services could be reduced considerably.

Professional Reputation

The professional reputation of Exponent and its consultants is critical to our ability to successfully compete for new client engagements and attract or retain professionals. Any factors that damage our professional reputation could have a material adverse effect on our business.

Regulation

Public concern over health, safety and preservation of the environment has resulted in the enactment of a broad range of environmental and/or other laws and regulations by local, state and federal lawmakers and agencies. These laws and the implementing regulations affect nearly every industry, as well as the agencies of federal, state and local governments charged with their enforcement. To the extent changes in such laws, regulations and enforcement or other factors significantly reduce the exposures of manufacturers, owners, service providers and others to

liability, the demand for our services may be significantly reduced.

Tort Reform

Several of our practices have a significant concentration in litigation support consulting services. To the extent tort reform reduces the exposure of manufacturers, owners, service providers and others to liability, the demand for our litigation support consulting services may be significantly reduced.

Variability of Quarterly Financial Results

Variations in our revenues and operating results occur from time to time, as a result of a number of factors, such as the significance of client engagements commenced and completed during a

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quarter, the timing of engagements, the number of working days in a quarter, employee hiring and utilization rates, and integration of companies acquired. Because a high percentage of our expenses, particularly personnel and facilities related expenses, are relatively fixed in advance of any particular quarter, a variation in the timing of the initiation or the completion of our client assignments can cause significant variations in operating results from quarter to quarter.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our Silicon Valley office facilities consist of a 153,738 square foot building, with office and laboratory space located on a 6.3-acre tract of land we own in Menlo Park, California and an adjacent 27,000 square feet of leased warehouse storage space.

Our Test and Engineering Center (TEC) occupies 147 acres in Maricopa County, Arizona. We lease this land from the state of Arizona under a 30-year lease agreement that expires in January 2028 and have options to renew for two fifteen-year periods. We constructed an indoor test facility as well as an engineering and test preparation building at the TEC.

In addition, we lease office, warehouse and laboratory space in 22 other locations in 13 states and the District of Columbia, as well as in Germany, China and the United Kingdom. Leases for these offices, warehouse and laboratory facilities have terms generally ranging between one and ten years. Aggregate lease expense in fiscal 2005 for all leased properties was $4,644,000.

Item 3. Legal Proceedings

Exponent is not engaged in any material legal proceedings.

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

No matters were submitted to a vote of security holders during the fourth quarter of fiscal 2005.

PART II

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

Exponent s common stock is traded on the NASDAQ National Market under the symbol EXPO . The following table sets forth for the fiscal periods indicated the high and low closing sales prices for our common stock.

Stock prices by quarter	High	Low
Fiscal Year Ended December 31, 2004:		
First Quarter	$ 24.84	$ 21.33
Second Quarter	$ 27.17	$ 22.52
Third Quarter	$ 27.55	$ 24.50
Fourth Quarter	$ 28.11	$ 26.58
Fiscal Year Ended December 30, 2005:		
First Quarter	$ 29.50	$ 22.88
Second Quarter	$ 29.11	$ 23.47
Third Quarter	$ 31.39	$ 27.54
Fourth Quarter	$ 30.65	$ 27.35
Fiscal Year Ended December 29, 2006:		
First Quarter (through February 24, 2006)	$ 33.25	$ 28.54

As of February 24, 2006, there were 358 holders of record of our common stock. Because many of the shares of our common stock are held by brokers and other institutions on behalf of stockholders, we believe that there are considerably more beneficial holders of our common stock than record holders.

We have never paid cash dividends on our common stock. See Item 7 of Part II Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources.

We did not repurchase any of our common stock during the quarter ended December 30, 2005. See Item 7 of Part II Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources for information regarding our stock repurchase programs.

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Item 6. Selected Consolidated Financial Data

The following selected consolidated financial data are derived from our consolidated financial statements. This data should be read in conjunction with the consolidated financial statements and notes thereto, and with Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations.

	Fiscal Year				
(In thousands, except per share data)	2005	2004	2003	2002	2001
Consolidated Statements of Income Data:					
Revenues before reimbursements	$ 142,861	$ 138,718	$ 125,943	$ 115,298	$ 104,497
Revenues	$ 155,196	$ 151,509	$ 139,676	$ 126,055	$ 114,461
Operating income	$ 20,380	$ 19,324	$ 16,902	$ 14,036	$ 9,779
Net income	$ 14,186	$ 12,040	$ 10,166	$ 7,924	$ 6,122
Net income per share:					
Basic	$ 1.75	$ 1.56	$ 1.41	$ 1.16	$ 0.94
Diluted	$ 1.62	$ 1.41	$ 1.27	$ 1.05	$ 0.85
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$ 13,216	$ 4,680	$ 5,666	$ 22,480	$ 7,815
Short-term investments	$ 55,682	$ 55,366	$ 35,932	$	$
Working capital	$ 93,755	$ 78,972	$ 57,519	$ 44,696	$ 31,747
Total assets	$ 164,241	$ 144,132	$ 121,842	$ 107,216	$ 91,034
Long-term liabilities	$ 4,631	$ 2,571	$ 2,494	$ 1,864	$ 1,192
Total stockholders equity	$ 133,200	$ 117,022	$ 95,118	$ 83,786	$ 70,531

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

Forward-looking statements

The statements in this report that are not statements of historical fact are forward-looking statements and are based on current expectations and actual results may differ materially. These forward-looking statements involve numerous risks and uncertainties that could cause actual results to differ materially, including but not limited to, the possibility that the demand for our services may decline as a result of changes in general and industry specific economic conditions and the effects of competitive services and pricing; one or more current or future claims made against us may result in substantial liabilities; and such other risks and uncertainties as are described in reports and other documents we file from time to time with the Securities and Exchange Commission.

Overview

Exponent, Inc. is a science and engineering consulting firm that provides solutions to complex problems. Our multidisciplinary team of scientists, physicians, engineers, business and regulatory consultants brings together more than 70 different technical disciplines to solve complicated issues facing industry and government today. Our services include analysis of products, people, property, processes and finances related to litigation, product recall, regulatory compliance, research, development and design.

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CRITICAL ACCOUNTING ESTIMATES

In preparing our consolidated financial statements, we make assumptions, judgments and estimates that can have a significant impact on our revenue, operating income and net income, as well as on the value of certain assets and liabilities on our consolidated balance sheet. We base our assumptions, judgments and estimates on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results could differ materially from these estimates under different assumptions or conditions. On a regular basis we evaluate our assumptions, judgments and estimates and make changes accordingly. We believe that the assumptions, judgments and estimates involved in the accounting for revenue recognition, estimating the allowance for doubtful accounts, accounting for income taxes and valuing goodwill have the greatest potential impact on our consolidated financial statements, so we consider these to be our critical accounting policies. We discuss below the critical accounting estimates associated with these policies. Historically, our assumptions, judgments and estimates relative to our critical accounting policies have not differed materially from actual results. For further information on our critical accounting policies, see Note 1 of our Notes to Consolidated Financial Statements.

Revenue recognition. We derive our revenues primarily from professional fees earned on consulting engagements and fees earned for the use of our equipment and facilities, as well as reimbursements for outside direct expenses associated with the services that are billed to our clients.

Substantially all of our engagements are performed under time and material or fixed-price billing arrangements. On time and material and fixed-price projects, revenue is generally recognized as the services are performed. For substantially all of our fixed-price engagements we recognize revenue based on the relationship of incurred labor hours at standard rates to our estimate of the total labor hours at standard rates we expect to incur over the term of the contract. Our estimate of total labor hours we expect to incur over the term of the contract is based on the nature of the project and our past experience on similar projects. We believe this methodology achieves a reliable measure of the revenue from the consulting services we provide to our customers under fixed-price contracts.

Significant management judgments and estimates must be made and used in connection with the revenues recognized in any accounting period. These judgments and estimates include an assessment of collectibility and, for fixed-price engagements, an estimate as to the total effort required to complete the project. If we made different judgments or utilized different estimates, the amount and timing of our revenue for any period could be materially different.

All consulting contracts are subject to review by management, which requires a positive assessment of the collectibility of contract amounts. If, during the course of the contract, we determine that collection of revenue is not reasonably assured, we do not recognize the revenue until its collection becomes reasonably assured, which is generally upon receipt of cash. We assess collectibility based on a number of factors, including past transaction history with the client, as well as the credit-worthiness of the client. Losses on fixed-price contracts are recognized during the period in which the loss first becomes evident. Contract losses are determined to be the amount by which the estimated total costs of the contract exceeds the total fixed price of the contract.

Estimating the allowance for doubtful accounts. We must make estimates of our ability to collect accounts receivable and our unbilled work-in-process. In circumstances where we are aware of a specific customer s inability to meet its financial obligations to us, we record a specific allowance to reduce the net recognized receivable to the amount we reasonably believe will be collected. For all other customers we recognize allowances for doubtful accounts based upon historical bad debts, customer concentration, customer credit-worthiness, current economic conditions and changes in customer payment terms. As of December 30, 2005, our accounts receivable balance was $46.2 million, net of an allowance for doubtful accounts of $1.2 million.

Accounting for income taxes. In preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions where we operate. This process involves estimating actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent that we believe that recovery is not likely, we must establish a valuation allowance.

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Significant judgment is required in determining the provision for income taxes, deferred tax assets and liabilities and any valuation allowance against our deferred tax assets, such as current tax laws, our interpretation of current tax laws and possible outcomes of current and future audits conducted by foreign and domestic tax authorities. In the event that actual results differ from these estimates or the estimates are adjusted in future periods, then we may need to establish a valuation allowance, which could materially impact our financial position and results of operations. Based on our current financial projections and operating plan for fiscal 2006, we currently believe that we will be able to utilize our deferred tax assets.

Valuing goodwill. We assess the impairment of goodwill annually or more frequently if certain triggering events occur indicating that the carrying value of goodwill may be impaired. Factors that we consider when evaluating for possible impairment include the following:

- significant under-performance relative to expected historical or projected future operating results;
- significant changes in the manner of our use of the acquired assets or the strategy for our overall business; and
- significant negative economic trends.

When evaluating our goodwill for impairment, based upon the existence of one or more of the above factors, we determine the existence of an impairment by assessing the fair value of the applicable reporting unit, including goodwill, using expected future cash flows to be generated by the reporting unit. If the carrying amount of a reporting unit exceeds its fair value, then an impairment loss is recognized for any excess of the carrying amount of the reporting unit s goodwill over the implied fair value of that goodwill.

We completed our annual impairment review as of the end of the 47th week of fiscal 2005 and determined that we had no impairment of our goodwill and therefore did not record an impairment charge. As of December 30, 2005, goodwill totaled $8.6 million.

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CONSOLIDATED RESULTS OF OPERATIONS

The following table sets forth for the periods indicated, the percentage of revenues of certain items in our consolidated statements of income and the percentage increase (decrease) in the dollar amount of such items year to year:

	PERCENTAGE OF REVENUES FOR FISCAL YEARS			PERIOD TO PERIOD CHANGE	
	2005	2004	2003	2005 vs. 2004	2004 vs. 2003
Revenues	100.0%	100.0%	100.0%	2.4%	8.5%
Operating expenses:					
Compensation and related expenses	59.3	58.9	58.2	3.1	9.8
Other operating expenses	12.0	12.4	12.8	(1.0)	5.1
Reimbursable expenses	8.0	8.4	9.8	(3.6)	(6.9)
General and administrative expenses	6.3	6.4	6.3	0.3	10.8
Stock-based compensation	1.3	1.1	0.8	29.8	48.9
	86.9	87.2	87.9	2.0	7.7
Operating income	13.1	12.8	12.1	5.5	14.3
Other income, net	1.5	0.7	0.6	107.4	35.9
Income before income taxes	14.6	13.5	12.7	10.9	15.3
Provision for income taxes	5.5	5.6	5.4	0.8	11.1
Net income	9.1%	7.9%	7.3%	17.8%	18.4%

OVERVIEW OF THE YEAR ENDED DECEMBER 30, 2005

During fiscal 2005, we had a 2.4% increase in revenues as compared to fiscal 2004. This growth was driven primarily by our civil engineering and biomechanics practices. Our civil engineering practice had a strong year as we assisted our clients with the aftermath of hurricanes Katrina and Rita. In our biomechanics practice, we continued to grow our business, working with clients in their medical device development as well as in accident injury analysis. This growth was offset by lower revenues in our technology development practice due to a decrease in the number of large projects with the United States Department of Defense.

Our revenue growth was driven primarily by higher billing rates. Total billable hours increased 0.4% to 713,000 during fiscal 2005 as compared to 710,000 during fiscal 2004. Technical full-time equivalents decreased 0.2% to 520 for fiscal 2005 as compared to 521 during fiscal 2004. Utilization was 66% during fiscal 2005 and 2004. Through the management of

our operating expenses we were able to leverage this revenue growth to improve operating income by 5.5%. This increase in operating income, an increase in other income and a reduction in our effective tax rate resulted in a 17.8% increase in net income as compared to fiscal 2004.

FISCAL YEARS ENDED DECEMBER 30, 2005, AND DECEMBER 31, 2004

Revenues

Our revenues consist of professional fees earned on consulting engagements, fees for use of our equipment and facilities, as well as reimbursements for outside direct expenses associated with the services performed that are billed to our clients. We operate on a 52-53 week fiscal year with each year ending on the Friday closest to December 31st. The fiscal years ended December 30, 2005, December 31, 2004 and January 2, 2004 included 52 weeks of activity.

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(In thousands)	Fiscal Years 2005	2004	Percent Change
Engineering and other scientific	$ 119,037	$ 115,558	3.0%
Percentage of total revenues	76.7%	76.3%	
Environmental and health	36,159	35,951	0.6%
Percentage of total revenues	23.3%	23.7%	
Total revenues	$ 155,196	$ 151,509	2.4%

The increase in revenues for our engineering and other scientific segment during fiscal 2005 was the result of higher billing rates and an increase in billable hours. During fiscal 2005, billable hours for this segment increased by 1.1% to 535,000 as compared to 529,000 during fiscal 2004. Technical full-time equivalents for this segment increased by 1.9% to 380 during fiscal 2005 as compared to 373 during fiscal 2004. Utilization for this segment was 68% during fiscal 2005 and 2004.

The increase in revenues for our environmental and health segment during fiscal 2005 was the result of higher billing rates, partially offset by a decrease in billable hours. During fiscal 2005 billable hours for this segment decreased by 1.7% to 178,000 as compared to 181,000 during fiscal 2004. This decrease in billable hours was primarily due to a decrease in the volume and size of new and recurring engagements in our environmental practice. This practice operates in one of our more competitive markets. The decrease in billable hours for this practice was partially offset by an increase in billable hours for our food & chemicals practice. Technical full-time equivalents for this segment decreased by 6.1% to 139 during fiscal 2005 as compared to 148 during fiscal 2004. Utilization for this segment increased to 61% for fiscal 2005 as compared to 59% for fiscal 2004.

Revenues are primarily derived from services provided in response to client requests or events that occur without notice and engagements are generally terminable or subject to postponement or delay at any time by our clients. As a result, backlog at any particular time is small in relation to our quarterly or annual revenues and is not a reliable indicator of revenues for any future periods.

Compensation and Related Expenses

(In thousands)	Fiscal Years 2005	2004	Percent Change
Compensation and related expenses	$ 91,960	$ 89,193	3.1%
Percentage of total revenues	59.3%	58.9%	

The increase in compensation and related expenses during fiscal 2005 was due to the effects of our annual salary increase and an increase in bonuses. Our annual salary increase, which was approximately 5%, took effect at the beginning of April 2005. Bonuses are based on profitability and increased by $700,000 during fiscal 2005 as compared to fiscal 2004. We expect compensation and related expenses to increase due to the anticipated hiring of additional staff and the impact of future annual salary increases.

Other Operating Expenses

(In thousands)	Fiscal Years 2005	2004	Percent Change
Other operating expenses	$ 18,618	$ 18,801	(1.0)%
Percentage of total revenues	12.0%	12.4%	

The decrease in other operating expenses during fiscal 2005 was primarily due to the write-off of a foreign real estate investment for $230,000 during fiscal 2004. There was no such write-off during fiscal 2005. This decrease was partially offset by an increase in occupancy expense of $110,000. We anticipate other operating expenses to increase due to the support associated with the anticipated hiring of additional staff and the anticipated expansion of our offices.

Reimbursable Expenses

	Fiscal Years		Percent
(In thousands)	**2005**	**2004**	**Change**
Reimbursable expenses	$ 12,335	$ 12,791	(3.6)%
Percentage of total revenues	8.0%	8.4%	

The decrease in reimbursable expenses during fiscal 2005 was primarily due to a decrease in purchases of technical materials related to projects in our technology development practice.

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General and Administrative Expenses

	Fiscal Years		Percent
(In thousands)	**2005**	**2004**	**Change**
General and administrative expenses	$ 9,831	$ 9,804	0.3%
Percentage of total revenues	6.3%	6.4%	

The increase in general and administrative expenses during fiscal 2005 was primarily due to an increase in recruiting expense of $185,000 and an increase in professional development expense of $72,000, partially offset by a decrease in bad debt expense of $182,000. The increase in recruiting and professional development expense was due to our efforts to attract and develop technical consultants. The decrease in bad debt expense was due to a decrease in write-offs during fiscal 2005 as compared to fiscal 2004 and a decrease in the allowance for doubtful accounts at year-end.

Stock-Based Compensation

	Fiscal Years		Percent
(In thousands)	**2005**	**2004**	**Change**
Stock-based compensation	$ 2,072	$ 1,596	29.8%
Percentage of total revenues	1.3%	1.1%	

Stock-based compensation consists primarily of the expense associated with restricted stock units granted to employees under our Restricted Stock Plan. For a select group of employees, up to 30% of their annual bonus is settled with fully vested restricted stock unit awards (bonus awards). Each employee who receives a bonus award also receives a matching number of unvested restricted stock unit awards (matching awards). The bonus awards and matching awards are typically granted during the first quarter of each year subsequent to the year the bonus awards were earned. Matching awards cliff vest four years from the date of grant. The portion of our annual bonus that we expect to settle with bonus awards is recorded as stock-based compensation during the period the bonus is earned. Matching awards are recorded as deferred stock-based compensation upon grant and are amortized as stock-based compensation over the vesting period of the matching award.

The increase in stock-based compensation during fiscal 2005 was primarily due to an increase in accrued bonus awards of 9.6% to $1,468,000 during fiscal 2005 as compared to $1,340,000 during fiscal 2004. This increase is due to a corresponding

increase in profitability. Also contributing to the increase in stock-based compensation during fiscal 2005 was an increase in the amortization of matching awards of 181% to $501,000 during fiscal 2005 as compared to $178,000 during fiscal 2004. The increase in the amortization of the matching awards was due to the matching awards granted during fiscal 2005. Fiscal 2004 was the first year we granted matching awards. We expect the amortization of matching awards to continue to increase during the next two years as new awards are granted and previously granted awards continue to vest.

Other Income and Expense

	Fiscal Years		Percent
(In thousands)	**2005**	**2004**	**Change**
Other income and expense	$ 2,238	$ 1,079	107.4%
Percentage of total revenues	1.5%	0.7%	

Other income and expense, net, consists primarily of investment income earned on available cash, cash equivalents and short-term investments, rental income from leasing excess space in our Silicon Valley facility, and changes in the value of assets associated with our deferred compensation plan. The increase in other income and expense during fiscal 2005 was primarily due to an increase in interest income of $734,000, an increase in the fair value of deferred compensation plan assets of $220,000 and an increase in rental income of $148,000. The increase in interest income was due to higher balances of cash, cash equivalents and short-term investments and an increase in short term interest rates. Rental income increased due to the addition of a new tenant in our Silicon Valley facility.

Income Taxes

(In thousands)	Fiscal Years 2005	2004	Percent Change
Income taxes	$ 8,432	$ 8,363	0.8%
Percentage of total revenues	5.5%	5.6%	
Effective tax rate	37.3%	41.0%	

The decrease in our effective tax rate during fiscal 2005 was primarily due to a $272,000 true-up related to differences in estimated versus actual federal and state income taxes for fiscal 2004. An increase in tax-exempt interest income also contributed to a decrease in our effective tax rate during fiscal 2005.

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We expect our effective income tax rate to increase to approximately 39.0% for fiscal 2006.

FISCAL YEARS ENDED DECEMBER 31, 2004, AND JANUARY 2, 2004

Revenues

	Fiscal Years		Percent
(In thousands)	**2004**	**2003**	**Change**
Engineering and other scientific	$ 115,558	$ 103,283	11.9%
Percentage of total revenues	76.3%	73.9%	
Environmental and health	35,951	36,393	(1.2)%
Percentage of total revenues	23.7%	26.1%	
Total revenues	$ 151,509	$ 139,676	8.5%

The increase in revenues for our engineering and other scientific segment during fiscal 2004 was the result of an increase in billable hours and higher billing rates. During fiscal 2004 billable hours for this segment increased by 8.4% to 529,000 as compared to 488,000 during fiscal 2003. This growth in billable hours was due to our ability to attract new and recurring engagements during fiscal 2004. Technical full-time equivalents for this segment increased by 8.1% to 373 during fiscal 2004 as compared to 345 during fiscal 2003. Utilization for this segment was 68% during fiscal 2004 and 2003.

The decrease in revenues for our environmental and health segment during fiscal 2004 was the result of a decrease in billable hours partially offset by higher billing rates. During fiscal 2004 billable hours for this segment decreased by 5.7% to 181,000 as compared to 192,000 during fiscal 2003. This decrease in billable hours was primarily due to a decrease in the volume and size of new and recurring engagements in our environmental practice. This practice operates in one of our more competitive markets. In addition, our limited backlog causes variability in our annual revenues. Technical full-time equivalents for this segment decreased by 0.7% to 148 during fiscal 2004 as compared to 149 during fiscal 2003. Utilization for this segment was 59% for fiscal 2004 as compared to 62% for fiscal 2003.

Revenues are primarily derived from services provided in response to client requests or events that occur without notice and engagements are generally

terminable or subject to postponement or delay at any time by our clients. As a result, backlog at any particular time is small in relation to our quarterly or annual revenues and is not a reliable indicator of revenues for any future periods.

Compensation and Related Expenses

	Fiscal Years		Percent
(In thousands)	**2004**	**2003**	**Change**
Compensation and related expenses	$ 89,193	$ 81,225	9.8%
Percentage of total revenues	58.9%	58.2%	

The increase in compensation and related expenses during fiscal 2004 was due to the effects of our annual salary increase, an increase in full-time equivalents, higher fringe benefits and an increase in bonuses. Our annual salary increase, which was approximately 5%, took effect at the beginning of April 2004. Technical full-time equivalents increased 5.6% during fiscal 2004 as compared to fiscal 2003. Fringe benefits increased $1.3 million due primarily to increases in health insurance, employer 401(k) contributions, workers compensation and payroll taxes. Bonuses are based on profitability and increased by $817,000 during fiscal 2004 as compared to fiscal 2003.

Other Operating Expenses

(In thousands)	Fiscal Years 2004	2003	Percent Change
Other operating expenses	$ 18,801	$ 17,897	5.1%
Percentage of total revenues	12.4%	12.8%	

The increase in other operating expenses during fiscal 2004 was primarily due to the write-off of a foreign real estate investment for $230,000 during fiscal 2004. Other individually insignificant increases in computer expenses, technical materials, occupancy expenses and office expenses contributed to the remaining increase. These increases were due to a corresponding increase in full-time equivalents.

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Reimbursable Expenses

	Fiscal Years		Percent
(In thousands)	2004	2003	Change
Reimbursable expenses	$ 12,791	$ 13,733	(6.9)%
Percentage of total revenues	8.4%	9.8%	

The decrease in reimbursable expenses during fiscal 2004 was primarily due to a decrease in purchases of technical materials related to projects in our technology development practice.

General and Administrative Expenses

	Fiscal Years		Percent
(In thousands)	2004	2003	Change
General and administrative expenses	$ 9,804	$ 8,847	10.8%
Percentage of total revenues	6.4%	6.3%	

The increase in general and administrative expenses during fiscal 2004 was primarily due to an increase in bad debt expense, outside consulting fees, marketing and business development, and other professional services. The increase in bad debt expense of $296,000 was due to an increase in write-offs during fiscal 2004 as compared to fiscal 2003 and an increase in the allowance for doubtful accounts at year-end. Outside consulting fees increased by $262,000 during fiscal 2004 due primarily to $216,000 in sub-contractor fees related to a potential project with the United States government which was not executed by year-end. Marketing and business development increased by $216,000 due to our efforts to generate new and recurring engagements. Other professional services increased by $166,000 primarily due to corporate governance related expenses.

Stock-Based Compensation

	Fiscal Years		Percent
(In thousands)	2004	2003	Change
Stock-based compensation	$ 1,596	$ 1,072	48.9%
Percentage of total revenues	1.1%	0.8%	

The increase in stock-based compensation during fiscal 2004 was due to an increase in accrued bonus awards of 36.2% to $1,340,000 during fiscal 2004 as compared to $984,000 during fiscal 2003. This

increase is due to a corresponding increase in profitability. Also contributing to the increase in stock-based compensation during fiscal 2004 was $178,000 in amortization of matching awards. Fiscal 2004 was the first year we granted matching awards.

Other Income and Expense

	Fiscal Years		Percent
(In thousands)	2004	2003	Change
Other income and expense	$ 1,079	$ 794	35.9%
Percentage of total revenues	0.7%	0.6%	

The increase in other income and expense, net, during fiscal 2004 was primarily due to an increase in interest income of $337,000 resulting from higher balances of cash, cash equivalents and short-term investments and an increase in short term interest rates.

Income Taxes

(In thousands)	Fiscal Years 2004	2003	Percent Change
Income taxes	$ 8,363	$ 7,530	11.1%
Percentage of total revenues	5.6%	5.4%	
Effective tax rate	41.0%	42.6%	

The decrease in our effective tax rate during fiscal 2004 was primarily due to an increase in tax-exempt interest income and a change in our apportionment to states with lower statutory income tax rates.

RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R). In March 2005, the Securities and Exchange Commission (SEC) released Staff Accounting Bulletin (SAB) 107, Share-Based Payment, which expresses views of the SEC Staff about the application of SFAS 123R. We will adopt SFAS 123R in the first quarter of fiscal 2006 using the modified prospective method. Under the modified prospective method, compensation cost is recognized for all share-based payments granted after the effective date as well as for all share-based payments granted prior to the effective date which remain unvested on the effective date. SFAS 123R will

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result in the recognition of substantial compensation expense relating to our employee stock option plans. We currently use the intrinsic value method to measure compensation expense for stock-based awards to our employees. Under this method, we generally do not recognize any compensation expense related to stock option grants issued under our stock option plans. Under the new rules, we are required to adopt a fair-value-based method for measuring the compensation expense related to employee stock awards which will lead to substantial additional compensation expense. The paragraph entitled *Stock-Based Compensation* included in Note 1 to our consolidated financial statements provides the pro-forma net income and earnings per share as if we had used a fair-value-based method similar to the methods required under SFAS 123R to measure the compensation expense for employee stock-based awards during fiscal 2005, 2004 and 2003.

LIQUIDITY AND CAPITAL RESOURCES

(in thousands)	2005	2004	2003
Net ca			