

EXPONENT INC  
Form 10-K  
March 08, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-K**

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**x Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the fiscal year ended December 29, 2006.

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

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**EXPONENT, INC.**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of

incorporation or organization)

**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**

**77-0218904**  
(IRS employer

identification no.)

## Edgar Filing: EXPONENT INC - Form 10-K

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**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)**

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

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 ☒

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☒ 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 ☒

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 June 30, 2006, the last business day of the registrant's most recently completed second quarter, was \$218,402,435. 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 June 30, 2006 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 23, 2007 was 14,786,424.

### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Definitive Proxy Statement for the Registrant's 2007 Annual Meeting of Stockholders to be held on May 22, 2007, 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 29, 2006**

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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 current

or 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, tort reform 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 update or revise 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 90 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 related to 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 generally 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**

In 2007, the firm celebrates 40 years of technical excellence. From its beginning in 1967, it has expanded its service offerings from mechanical engineering and materials science to over 90 technical disciplines. Exponent's service offerings are provided on a project-by-project basis. Many projects require support from multiple practices. We currently operate 19 practices and centers, including:

Biomechanics

Civil Engineering

Construction Consulting

EcoSciences

Electrical & Semiconductors

Environmental Sciences

Health Sciences

Center for Chemical Registration and Food Safety

Center for Epidemiology, Biostatistics and Computational Biology

Center for Toxicology and Mechanistic Biology

Center for Exposure Assessment and Dose Reconstruction

Center for Public Health and Industrial Hygiene

Human Factors

Industrial Structures

Mechanical Engineering & Materials Science

Statistical & Data Sciences

Technology Development

Thermal Sciences

Vehicle Analysis

Visual Communications



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### **Biomechanics**

Exponent's Biomechanics staff uses engineering and biomedical science to explore the cause, nature and severity of injuries, and evaluate the performance of medical devices. 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.

In 2006, our staff published a study on joint replacements with the American Academy of Orthopaedic Surgeons (AAOS). As presented at the 73rd Annual Meeting of the AAOS, the study projects the number of hip and knee replacement procedures that will be performed in the United States through the year 2030. It was projected that the number of procedures for primary (first-time) total knee replacement would jump by almost 700 percent in 2030. The number of primary total hip replacements will increase by nearly 200 percent in 2030. Partial joint replacements were projected to increase by only 54 percent. Also expected to become more prevalent is the repair or replacement of the artificial joint, called revision joint replacement. The number of revision surgeries likely will double by 2015 for total knee replacement and by 2026 for total hip replacement. Currently, hip revisions outnumber knee revisions, but knee revisions should surpass hip revisions after 2007. The research team based its projections on historical procedure rates from 1990 to 2003, combined with population projections from the U.S. Census Bureau.

### **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.

During 2006 our consultants assisted 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. Following the October 15, 2006 earthquake off the Big Island of Hawaii, we performed structural and geotechnical evaluations for insurers and corporate clients. Our hydrologists are also addressing some of the key issues in floodplain management such as delineation of flood hazards, and the identification of possible measures to mitigate potential impacts.

### **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 and scientists 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 disruptions and inefficiencies, as well as the costs associated with these types of issues. They also identify the risks associated with large-scale, complex construction projects and the proactive measures to take to avoid potential obstacles.

In 2006, Exponent's Construction Consulting practice continued to add staff and expand their construction dispute resolution services. In one particular matter Exponent was retained by a subcontractor who was being accused by the general contractor of delaying the completion of a project, which consisted of a 62 acre residential development with 324 living units in 28 three-story, wood framed buildings, and a community clubhouse and pool. Exponent analyzed the project's schedule record to determine the project's as-built critical path, and subsequently, quantify delays experienced along that path. In addition, Exponent analyzed and calculated the subcontractor's extended performance costs incurred as a result of seven months of overall project delay.

### **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



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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.

At the end of 2006, the practice added a new practice director and six consultants from Charles Menzie and Associates, a Boston-based environmental consulting practice. Their addition adds greatly to the firm's ability to assess environmental fate and effects of physical, biological, and chemical stressors on terrestrial and aquatic systems.

## **Electrical & Semiconductors**

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.

Over the past year, our office in China expanded its ability to provide independent manufacturing audit services for U.S. entities with manufacturing facilities in China. The safety evaluations of clients' pre-production products continued in the U.S. as well. These are performed to minimize corporate risk as well as help to reduce warranty claims and product recalls. 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.

In 2006, the practice began looking into environmental and health impacts related to coal fire power plants. According to reports, 153 new coal-fired power plants are currently proposed. Given the

concurrent boom in general concern over mercury in the environment and, specifically, atmospheric emissions from coal-fired power plants, the transport, fate, and effects of mercury will be a significant issue for most proposed plants. Our consultants have been outlining some of the key technical issues related to mercury emissions as well as identifying some of the key issues related to evaluation of the effects of increased mercury deposition on human health and the environment.

## **Health Sciences**

Exponent's Health Sciences group is comprised of 5 centers as described on the previous page and specializes in solving complex health problems that require an experienced team of multidisciplinary 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.

In June 2006, we added a new Group Vice President, Dr. Elizabeth Anderson, to lead our Health Sciences group. Dr. Anderson is an internationally recognized health scientist with over 30 years' experience in health and environmental sciences. One area of research that the group has been working on over the past year is the effect of nanomaterials on human health. By the end of 2006, nearly 400 consumer products were identified as containing nanoengineered materials. Nanotechnology involves working with matter on a very small scale, loosely defined as <100 nm in at least one dimension. Amid the excitement generated by the promising application of these miraculous technologies, concern has mounted over the limited understanding of potential product failures, nanomaterial releases, their effect on human health and the environment, and the lack of regulatory guidance specific to nanoengineered particles. Creation of safe, beneficial products containing nanomaterials involves a blending of materials sciences and product engineering with health and environmental sciences to help ensure that the full potential of this technology is realized.

Our Center for Chemical Registration and Food Safety includes experienced staff of both technical and regulatory specialists who are experienced in dealing



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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. During the past year we recruited significantly in the area of food safety and food borne illness and added several former members of the U.S. Food & Drug Administration to our staff.

During the past year, the Center for Chemical Registration and Food Safety continued to work with a number of European biocides manufacturers to evaluate data, produce data waiver argumentation, conduct human and environmental risk assessments, and produce summary dossiers of data that are required for ongoing regulatory review in Europe. In addition, we completed a study of the relationship between flavonoid intake and cardiovascular disease. Flavonoids are a class of antioxidant compound found in a number of plant foods, including vegetables, tea, wine, nuts, seeds, herbs and spices. The study found that dietary intake of flavones and anthocyanidins, and certain foods rich in flavonoids, appear to reduce the risk of death due to coronary heart disease and cardiovascular disease.

## **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. At the 2006 annual meeting of the Human Factors and Ergonomics Society, the group presented its finding on driver inattention related to backseat occupant behavior. The publication, "Who's in the Back Seat? A Study of Driver Inattention," discussed the difficulty of detecting objects in a scene to people who are already expecting to see them and are aware of the objects' presence. Visual performance limitations, environmental expectations and inattention blindness effects were some of the causes that contributed to driver's inability to see things around them—sometimes leading to tragic consequences.

## **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 & Materials Science**

As the largest technical practice at Exponent, 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 2006, our mechanical engineers and materials scientists worked on a number of international projects including projects in South America, the European Union and the Middle East. We also assisted a major electronic consumer product manufacturer analyze the design of products it planned to introduce into the market to assess potential failure and other risk mechanisms.

By using a multidisciplinary approach involving staff from a wide range of disciplines, we continue 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.

## **Statistical & Data Sciences**

All living humans continually bear a certain degree of risk of injury or death. Exponent's Statistical & Data Sciences (formerly 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.

Exponent recently developed and proposed the design of an experimental study to determine which concrete mixes will possess minimum permeability at cryogenic temperatures. Factors of interest included water/cement ratio, age at filling, and percent of silica. Observations at systematically chosen factor-level combinations can be used to estimate the response surface and the manufacturing settings that will produce optimum results. Planning for implementation of the study is underway.



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### **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 2006, 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. We continue to supply the U.S. Army with MARCbot – our multifunction, agile remote controlled robot for use in reconnaissance missions. Finally, we have been working with the U.S. Navy on a Network-Enabled Anti-Submarine Warfare (NEASW) sensor system. The NEASW system establishes a submarine barrier with a high probability of detection. Various configurations of the system can serve different strategic objectives: a barrier across a chokepoint, a perimeter around a sea base, or even a means of confirming and prosecuting submarines detected but not localized by a different sensor system. The system is currently under evaluation by the U.S. Navy.

### **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 2006, Exponent worked on a number of facility upsets, residential and commercial fires and fire protection evaluations. One of the more significant investigations was of the Buncefield Oil Storage Depot in the United Kingdom. On December 11, 2005, an explosion and fire occurred at Buncefield Oil Storage Depot, outside of London. The explosion measured 2.4 on the Richter scale and caused severe damage to neighboring buildings, and damaged windows over a mile from the site. The incident has been called one of the largest fires in Europe since World War II and caused large smoke plumes over Southern England. Despite the significant damage caused by the event there were no fatalities or serious injuries.

### **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.

In 2006, we continued to develop expertise in the analysis of the Event Data Recorder (EDR), which is a device installed in a motor vehicle to record technical vehicle and occupant information for a brief period of time (seconds, not minutes) before, during and after a crash. For instance, EDRs may record (1) pre-crash vehicle dynamics and system status, (2) driver inputs, (3) vehicle crash signature, (4) restraint usage/deployment status, and (5) post-crash data such as the activation of an automatic collision notification (ACN) system. In the October 2006 edition of the SAE Magazine, *Automotive Engineering International*, Exponent consultants published an article entitled "EDR's (Event Data Recorders) take to the road". In the article, we discussed the development of a new SAE Recommended Practice for heavy vehicle EDRs.

### **Visual Communications**

The Visual Communications practice combines art and science to help clients create compelling, fact-based visual displays that communicate complex subject matter, conveying important information to audiences unfamiliar with the matters at hand. Specific components include animation, graphics, multimedia and photography.

### **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.



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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 29, 2006, we employed 835 full-time and part-time employees, including 548

engineering and scientific staff, 110 technical support staff and 177 administrative and support staff. Our staff includes 453 employees with advanced degrees, of which 268 employees have achieved the level of Ph.D. or M.D.

## **ADDITIONAL INFORMATION**

The address of our internet website is [www.exponent.com](http://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. The content of our internet website is not incorporated into and is not part of this Annual Report on Form 10-K.

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The executive officers of Exponent and their ages as of March 7, 2007 are as follows:

| <b>Name</b>                  | <b>Age</b> | <b>Position</b>                                 |
|------------------------------|------------|-------------------------------------------------|
| Michael R. Gaulke            | 61         | President, Chief Executive Officer and Director |
| Elizabeth L. Anderson, Ph.D. | 67         | Group Vice President                            |
| Paul D. Boehm, Ph.D.         | 58         | Group Vice President                            |
| Robert D. Caligiuri, Ph.D.   | 55         | Group Vice President                            |
| Paul R. Johnston, Ph.D.      | 53         | Chief Operating Officer                         |
| Subbaiah V. Malladi, Ph.D.   | 60         | Chief Technical Officer                         |
| John E. Moalli, Sc.D.        | 42         | Group Vice President                            |
| John D. Osteraas, Ph.D.      | 53         | Group Vice President                            |
| Richard L. Schlenker, Jr.    | 41         | 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.

**Elizabeth L. Anderson, Ph.D.**, joined the Company in June 2006 as a Group Vice President. Prior to joining Exponent, Dr. Anderson was President and CEO of Sciences International, a health and environmental consulting firm. Dr. Anderson received her Ph.D. (1970) in Organic Chemistry from The American University, M.S. (1964) in Organic Chemistry from the University of Virginia and B.S. (1962) in Chemistry from the College of William and Mary. Dr. Anderson is a Fellow of the Academy of Toxicological Sciences, founder and past-President of the Society for Risk Analysis and Editor-in-Chief of the journal, Risk Analysis: An International Journal.

**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.

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**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 Principal Engineer in 1987, and to Vice President in 1996. In 1997, he assumed responsibility for the firm's network of offices. In July 2003, he was appointed Chief Operating Officer and added responsibility for the Health and Environmental Groups. In 2006, he assumed line responsibility for all of the firm's consulting groups. He received his Ph.D. (1981) in Civil Engineering and M.S. (1977) in Structural Engineering from Stanford University. He received his B.A.I. (1976) in Civil Engineering with First Class Honors from Trinity College, University of Dublin, Ireland where he was elected a Foundation Scholar in 1975. Dr. Johnston is a Registered Professional Civil 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.

**John D. Osteraas, Ph.D.** joined the Company in 1990. He was promoted to Principal Engineer in 1992 and Group Vice President in 2006. Dr. Osteraas received his Ph.D. (1990) in Civil Engineering and M.S. (1977) in Civil Engineering: Structural Engineering from Stanford University and B.S. (1976) in Civil and Environmental Engineering from the University of Wisconsin. Dr. Osteraas is a Registered Professional Engineer in nine states and is a Fellow of the American Society of Civil Engineers.

**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 17% of our revenues for the fiscal year ended

December 29, 2006. In addition, we performed engagements for the government sector, which accounted for approximately 10% of our revenues for the fiscal year ended December 29, 2006. 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 Phoenix, 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 21 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 2006 for all leased properties was \$4,804,000.

**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 2006.

**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Exponent's common stock is traded on the NASDAQ Global Select Market, which up until July 1, 2006 was 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.

| <b>Stock prices by quarter</b>              | <b>High</b> | <b>Low</b> |
|---------------------------------------------|-------------|------------|
| <b>Fiscal Year Ended December 30, 2005:</b> |             |            |
| First Quarter                               | \$ 14.75    | \$ 11.44   |
| Second Quarter                              | \$ 14.56    | \$ 11.74   |
| Third Quarter                               | \$ 15.70    | \$ 13.77   |
| Fourth Quarter                              | \$ 15.33    | \$ 13.68   |
| <b>Fiscal Year Ended December 29, 2006:</b> |             |            |
| First Quarter                               | \$ 16.63    | \$ 14.27   |
| Second Quarter                              | \$ 17.00    | \$ 14.94   |
| Third Quarter                               | \$ 17.55    | \$ 14.70   |
| Fourth Quarter                              | \$ 19.05    | \$ 16.60   |

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As of February 23, 2007, there were 348 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.

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The following table provides information on the Company's share repurchases for the quarter ended December 29, 2006:

| (In thousands, except price per share) | Total Number<br>of Shares<br>Purchased | Average Price<br>Paid Per Share | Total Number of<br>Shares Purchased as<br>Part of Publicly<br>Announced Programs | Approximate Dollar<br>Value of Shares That<br>May Yet Be Purchased<br>Under the<br>Program <sup>(1)</sup> |
|----------------------------------------|----------------------------------------|---------------------------------|----------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------|
| September 30 to October 27             | 84                                     | \$ 17.23                        | 84                                                                               | \$ 8,832                                                                                                  |
| October 28 to November 24              | 70                                     | \$ 18.03                        | 70                                                                               | \$ 7,577                                                                                                  |
| November 25 to December 29             | 125                                    | \$ 18.01                        | 125                                                                              | \$ 5,323                                                                                                  |
| Total                                  | 279                                    | \$ 17.86                        | 279                                                                              |                                                                                                           |

<sup>(1)</sup> In April 2006, the Company's Board of Directors approved a plan to repurchase up to \$35 million of the Company's common stock. The plan has no expiration date.

### COMPANY STOCK PRICE PERFORMANCE GRAPH

The graph compares the Company's cumulative total stockholder return calculated on a dividend-reinvested basis from 2001 through 2006 with those of the Standard & Poor's (S&P) 500 Index and the S&P SmallCap 600 Index. The Company does not have a comparable peer group and thus has selected the S&P Small Cap 600 Index. The graph assumes that \$100 was invested on the last day of 2001. Note that the historic stock price performance is not necessarily indicative of future stock price performance.

**Table of Contents****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.

| (In thousands, except per share data)   | Fiscal Year |            |            |            |            |
|-----------------------------------------|-------------|------------|------------|------------|------------|
|                                         | 2006        | 2005       | 2004       | 2003       | 2002       |
| Consolidated Statements of Income Data: |             |            |            |            |            |
| Revenues before reimbursements          | \$ 156,742  | \$ 142,861 | \$ 138,718 | \$ 125,943 | \$ 115,298 |
| Revenues                                | \$ 168,496  | \$ 155,196 | \$ 151,509 | \$ 139,676 | \$ 126,055 |
| Operating income                        | \$ 20,189   | \$ 20,380  | \$ 19,324  | \$ 16,902  | \$ 14,036  |
| Net income                              | \$ 14,194   | \$ 14,186  | \$ 12,040  | \$ 10,166  | \$ 7,924   |
| Net income per share:                   |             |            |            |            |            |
| Basic                                   | \$ 0.89     | \$ 0.88    | \$ 0.78    | \$ 0.71    | \$ 0.58    |
| Diluted                                 | \$ 0.83     | \$ 0.81    | \$ 0.71    | \$ 0.64    | \$ 0.53    |
| Consolidated Balance Sheet Data:        |             |            |            |            |            |
| Cash and cash equivalents               | \$ 5,238    | \$ 13,216  | \$ 4,680   | \$ 5,666   | \$ 22,480  |
| Short-term investments                  | \$ 52,844   | \$ 55,682  | \$ 55,366  | \$ 35,932  | \$         |
| Working capital                         | \$ 81,280   | \$ 93,755  | \$ 78,972  | \$ 57,519  | \$ 44,696  |
| Total assets                            | \$ 161,216  | \$ 164,241 | \$ 144,132 | \$ 121,842 | \$ 107,216 |
| Long-term liabilities                   | \$ 6,185    | \$ 4,631   | \$ 2,571   | \$ 2,494   | \$ 1,864   |
| Total stockholders' equity              | \$ 124,305  | \$ 133,200 | \$ 117,022 | \$ 95,118  | \$ 83,786  |

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations****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 90 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.

**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, valuing goodwill and accounting for stock-based compensation 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.



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**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 29, 2006, our accounts receivable balance was \$48.2 million, net of an allowance for doubtful accounts of \$1.8 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.

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 2007, 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.

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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 47<sup>th</sup> week of fiscal 2006 and determined that we had no impairment of our goodwill and therefore did not record an impairment charge. As of December 29, 2006, goodwill totaled \$8.6 million.

**Stock-based compensation.** We adopted the provisions of, and accounted for stock-based compensation in accordance with, Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS 123(R)) during fiscal 2006. We elected the modified-prospective method of adoption, under which prior periods are not revised for comparative purposes. Under the fair value recognition provisions of this statement, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the requisite service period.

We currently use the Black-Scholes option-pricing model to determine the fair value of stock options. The determination of the fair value of stock options on the date of grant using an

option-pricing model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables. These variables include the expected term of the options, our expected stock price volatility over the term of the options, risk-free interest rate and expected dividends.

We use historical exercise and post-vesting forfeiture and expiration data to estimate the expected term of options granted. The historical volatility of our common stock over a period of time equal to the expected term of the options granted is used to estimate expected volatility. We base the risk-free interest rate that we use in the option-pricing model on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term on the options. We do not anticipate paying any cash dividends in the foreseeable future and therefore use an expected dividend yield of zero in the option-pricing model. We are required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest. All share based payment awards are amortized on a straight-line basis over the requisite service periods of the awards.

If factors change and we employ different assumptions for estimating stock-based compensation expense in future periods or if we decide to use a different valuation model, the future periods may differ significantly from what we have recorded in the current period and could materially affect our operating income, net income and net income per share.

**Table of Contents****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<br>FOR FISCAL YEARS |        |        | PERIOD TO<br>PERIOD CHANGE |               |
|-------------------------------------|--------------------------------------------|--------|--------|----------------------------|---------------|
|                                     | 2006                                       | 2005   | 2004   | 2006 vs. 2005              | 2005 vs. 2004 |
|                                     | 2006                                       | 2005   | 2004   | 2006 vs. 2005              | 2005 vs. 2004 |
| Revenues                            | 100.0%                                     | 100.0% | 100.0% | 8.6%                       | 2.4%          |
| Operating expenses:                 |                                            |        |        |                            |               |
| Compensation and related expenses   | 62.8                                       | 60.5   | 59.9   | 12.7                       | 3.5           |
| Other operating expenses            | 11.8                                       | 12.0   | 12.4   | 6.8                        | (1.0)         |
| Reimbursable expenses               | 7.0                                        | 8.0    | 8.4    | (4.7)                      | (3.6)         |
| General and administrative expenses | 6.4                                        | 6.4    | 6.5    | 9.2                        | 0.7           |
|                                     | 88.0                                       | 86.9   | 87.2   | 10.0                       | 2.0           |
| Operating income                    | 12.0                                       | 13.1   | 12.8   | (0.9)                      | 5.5           |
| Other income, net                   | 2.0                                        | 1.5    | 0.7    | 51.4                       | 107.4         |
| Income before income taxes          | 14.0                                       | 14.6   | 13.5   | 4.2                        | 10.9          |
| Provision for income taxes          | 5.6                                        | 5.5    | 5.6    | 11.3                       | 0.8           |
| Net income                          | 8.4%                                       | 9.1%   | 7.9%   | 0.1%                       | 17.8%         |

**OVERVIEW OF THE YEAR ENDED DECEMBER 29, 2006**

During fiscal 2006, we had an 8.6% increase in revenues as compared to fiscal 2005. This growth was driven primarily by our civil engineering, construction consulting, mechanics and materials and biomechanics practices. Our civil engineering practice had a strong year as we assisted our clients in evaluating the impact of natural disasters. Construction consulting is a strategic growth area that we continued to expand during 2006. In our mechanics and materials practice we expanded our portfolio of projects in the energy sector and product design consulting work for consumer electronics companies. 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 an increase in billable hours and higher billing rates. Total billable hours increased 6.2% to 757,000 during fiscal 2006 as compared to 713,000 during fiscal 2005. The increase in billable hours was supported by a 9.4% increase in technical full-time equivalent employees to 568 during fiscal 2006 as compared to 519 during fiscal 2005. This increase in technical full time equivalent employees was due to our continuing recruiting and retention efforts. Utilization decreased to 64% for fiscal 2006 as compared to 66% for fiscal 2005. This decrease in utilization was due to the integration of our recently hired technical consultants. The decrease in utilization and the adoption of SFAS 123(R) negatively affected our operating income. As a result of the adoption of SFAS 123(R) our operating income and net income were \$1.2 million and \$850,000 lower, respectively.



**Table of Contents****FISCAL YEARS ENDED DECEMBER 29, 2006, AND DECEMBER 30, 2005****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 31<sup>st</sup>. The fiscal years ended December 29, 2006, December 30, 2005 and December 31, 2004 included 52 weeks of activity.

|                                  | Fiscal Years |            | Percent |
|----------------------------------|--------------|------------|---------|
| (In thousands)                   | 2006         | 2005       | Change  |
| Engineering and other scientific | \$ 130,960   | \$ 119,037 | 10.0%   |
| Percentage of total revenues     | 77.7%        | 76.7%      |         |
| Environmental and health         | 37,536       | 36,159     | 3.8%    |
| Percentage of total revenues     | 22.3%        | 23.3%      |         |
| Total revenues                   | \$ 168,496   | \$ 155,196 | 8.6%    |

The increase in revenues for our engineering and other scientific segment during fiscal 2006 was the result of higher billing rates and an increase in billable hours. During fiscal 2006, billable hours for this segment increased by 8.8% to 582,000 as compared to 535,000 during fiscal 2005. Technical full-time equivalents for this segment increased by 10.3% to 419 during fiscal 2006 as compared to 380 during fiscal 2005. Utilization for this segment decreased to 67% for fiscal 2006 as compared to 68% for fiscal 2005.

The increase in revenues for our environmental and health segment during fiscal 2006 was the result of higher billing rates, partially offset by a decrease in billable hours. During fiscal 2006 billable hours for this segment decreased by 1.7% to 175,000 as compared to 178,000 during fiscal 2005. This decrease in billable hours was primarily due to a decrease in the volume and size of new and recurring engagements in our ecosciences practice. This practice operates in one of our more competitive markets. Technical full-time equivalents for this segment increased by 7.2% to 149 during fiscal 2006 as compared to 139 during fiscal 2005. Utilization for this segment decreased to 57% for fiscal 2006 as compared to 61% for fiscal 2005.

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)                    | 2006         | 2005      | Change  |
| Compensation and related expenses | \$ 105,860   | \$ 93,963 | 12.7%   |
| Percentage of total revenues      | 62.8%        | 60.5%     |         |

The increase in compensation and related expenses during fiscal 2006 was due to an increase in payroll expense, stock-based compensation, and fringe benefits. Payroll expense increased by \$8.0 million due to a corresponding increase in technical full-time equivalent employees and the impact of our annual salary increase. Fringe benefits increased by \$1.3 million due to the increase in technical full-time equivalent employees. Stock-based compensation expense related to matching restricted stock units and stock options increased by \$1.6 million due primarily to the adoption of SFAS 123(R) during 2006. 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**

|                              | <b>Fiscal Years</b> |             | <b>Percent</b> |
|------------------------------|---------------------|-------------|----------------|
| <b>(In thousands)</b>        | <b>2006</b>         | <b>2005</b> | <b>Change</b>  |
| Other operating expenses     | \$ 19,886           | \$ 18,618   | 6.8%           |
| Percentage of total revenues | 11.8%               | 12.0%       |                |

Other operating expenses primarily include facilities related costs, technical materials, computer-related expenses and depreciation and amortization of property, equipment and leasehold improvements. The increase in other operating expenses was primarily due to an increase of \$650,000 in occupancy expense, an increase of \$285,000 in computer-related expenses, and a \$223,000 increase in depreciation and amortization. The increase in occupancy expense, computer-related expenses, and depreciation and amortization were due to expansion in certain offices to support our increase in technical-full time equivalent employees. 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.

**Table of Contents****Reimbursable Expenses**

|                              | Fiscal Years |           | Percent |
|------------------------------|--------------|-----------|---------|
| (In thousands)               | 2006         | 2005      | Change  |
| Reimbursable expenses        | \$ 11,754    | \$ 12,335 | (4.7)%  |
| Percentage of total revenues | 7.0%         | 8.0%      |         |

The decrease in reimbursable expenses during fiscal 2006 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)                      | 2006         | 2005     | Change  |
| General and administrative expenses | \$ 10,807    | \$ 9,900 | 9.2%    |
| Percentage of total revenues        | 6.4%         | 6.4%     |         |

The increase in general and administrative expenses during fiscal 2006 was primarily due to an increase in travel and meals of \$388,000 and an increase in other professional services of \$295,000. The increase in travel and meals was primarily due to our increase in technical full-time equivalent employees and an increase in business development activities. The increase in outside consulting services was primarily due to \$216,000 in sub-contractor fees related to a potential project with the United States government that was not executed by the end of fiscal 2004. This project was executed during the first quarter of fiscal 2005 and the sub-contractor fees previously expensed were recovered. The recovery of these expenses during fiscal 2005 contributed to the period-to-period increase in outside consulting services.

**Other Income and Expense**

|                              | Fiscal Years |          | Percent |
|------------------------------|--------------|----------|---------|
| (In thousands)               | 2006         | 2005     | Change  |
| Other income and expense     | \$ 3,389     | \$ 2,238 | 51.4%   |
| Percentage of total revenues | 2.0%         | 1.5%     |         |

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

2006 was primarily due to an increase in interest income of \$723,000, an increase in the fair value of deferred compensation plan assets of \$251,000 and an increase in rental income of \$94,000. 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**

|                              | Fiscal Years |          | Percent |
|------------------------------|--------------|----------|---------|
| (In thousands)               | 2006         | 2005     | Change  |
| Income taxes                 | \$ 9,384     | \$ 8,432 | 11.3%   |
| Percentage of total revenues | 5.6%         | 5.5%     |         |

## Edgar Filing: EXPONENT INC - Form 10-K

|                    |       |       |
|--------------------|-------|-------|
| Effective tax rate | 39.8% | 37.3% |
|--------------------|-------|-------|

The increase in our effective tax rate during fiscal 2006 was primarily due to \$150,000 in additional income tax expense related to a change in estimated federal and state income taxes for 2005. During fiscal 2005 we recorded a credit of \$272,000 to income tax expense related to a change in estimated federal and state income taxes for 2004.

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

#### Revenues

|                                  | Fiscal Years |            | Percent |
|----------------------------------|--------------|------------|---------|
| (In thousands)                   | 2005         | 2004       | 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.

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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.

**Compensation and Related Expenses**

| (In thousands)                    | Fiscal Years |           | Percent Change |
|-----------------------------------|--------------|-----------|----------------|
|                                   | 2005         | 2004      |                |
| Compensation and related expenses | \$ 93,963    | \$ 90,760 | 3.5%           |
| Percentage of total revenues      | 60.5%        | 59.9%     |                |

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.

**Other Operating Expenses**

| (In thousands)               | Fiscal Years |           | Percent Change |
|------------------------------|--------------|-----------|----------------|
|                              | 2005         | 2004      |                |
| 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.

**Reimbursable Expenses**

| (In thousands)               | Fiscal Years |           | Percent Change |
|------------------------------|--------------|-----------|----------------|
|                              | 2005         | 2004      |                |
| 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.

**General and Administrative Expenses**

| (In thousands)                      | Fiscal Years |          | Percent Change |
|-------------------------------------|--------------|----------|----------------|
|                                     | 2005         | 2004     |                |
| General and administrative expenses | \$ 9,900     | \$ 9,833 | 0.7%           |
| Percentage of total revenues        | 6.4%         | 6.5%     |                |

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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.

### 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%     |         |

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.

**Table of Contents****Income Taxes**

|                              | Fiscal Years |          | Percent |
|------------------------------|--------------|----------|---------|
| (In thousands)               | 2005         | 2004     | 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.

**RECENT ACCOUNTING PRONOUNCEMENTS**

In September 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards No. 157 ( SFAS 157 ), Fair Value Measurements, which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. SFAS 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. Earlier adoption is permitted, provided the company has not yet issued financial statements, including for interim periods, for that fiscal year. We are currently evaluating the impact of SFAS 157, but do not expect the adoption of SFAS 157 to have a material impact on our consolidated financial position, results of operations or cash flows.

In July 2006, the Financial Accounting Standards Board issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes. An Interpretation of FASB Statement No. 109 (FIN 48), which clarifies the accounting for uncertainty in tax positions. This interpretation requires that companies recognize in their financial statements the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. We do not expect the adoption of FIN 48 to have a material impact on our consolidated financial position, results of operations or cash flows.

**LIQUIDITY AND CAPITAL RESOURCES**

| (in thousands)                  | 2006        | 2005       | 2004        |
|---------------------------------|-------------|------------|-------------|
| Net cash provided by (used in): |             |            |             |
| Operating activities            | \$ 19,582   | \$ 13,815  | \$ 16,038   |
| Investing activities            | \$ (795)    | \$ (4,347) | \$ (22,716) |
| Financing activities            | \$ (26,974) | \$ (869)   | \$ 5,646    |

We financed our business in fiscal 2006 principally through available cash and cash flows from operating activities. We invest our excess cash in cash equivalents and short-term investments. At the end of fiscal 2006, we had \$58.1 million in cash, cash equivalents and short-term investments compared to \$68.9 million at the end of the prior year. We also maintain a revolving reducing mortgage note, secured by our headquarters building. As of December 29, 2006, our available borrowings under this mortgage note were \$19.4 million and the outstanding balance was \$0.

The increase in cash provided by operating activities during fiscal 2006 as compared to fiscal 2005 was due to a smaller increase in accounts receivable and an increase in stock-based compensation partially offset by an increase in deferred income taxes. The smaller increase in accounts receivable was driven by lower days sales outstanding, which decreased to 94 days in fiscal 2006 as compared to 101 days in fiscal 2005. Stock-based compensation was \$4.4 million during fiscal 2006 as compared to \$2.1 million during fiscal 2005. The increase in stock-based compensation was primarily due to the adoption of SFAS 123(R) during fiscal 2006. During fiscal 2006 deferred income taxes were \$3.2 million as compared to \$1.5 million during fiscal 2005. The increase in deferred income taxes was due to the corresponding increase in stock-based compensation expense and an increase in amounts deferred under our non-qualified deferred compensation plan.

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The decrease in cash provided by operating activities during fiscal 2005 as compared to fiscal 2004 was due to an increase in accounts receivable and a decrease in tax benefit for stock option plans offset by an increase in net income and an increase in deferred revenues. Accounts receivable increased due to an increase in revenues and higher days sales outstanding, which increased to 101 days in fiscal 2005 as compared to 87 days in fiscal 2004. The increase in days sales outstanding was primarily due to slower payment on two of our largest projects during fiscal 2005. The decrease in tax benefit for stock option plans was due to a decrease in stock

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option exercises. These changes were offset by an increase in net income of \$2.1 million during fiscal 2005 as compared to fiscal 2004 and an increase in deferred revenues due to more pre-billed fixed-price projects in process at the end of fiscal 2005 as compared to fiscal 2004.

During fiscal 2006, 2005 and 2004, net cash used in investing activities primarily related to the purchase and sale or maturity of short-term investments.

The increase in net cash used in financing activities during fiscal 2006 was primarily due to an increase in repurchases of our common stock under our stock repurchase programs. The decrease in net cash provided by financing activities during fiscal 2005, as compared to fiscal 2004, was due to a decrease in proceeds from the issuance of common stock and an increase in common stock repurchases. Proceeds from the issuance of common stock are primarily related to the exercise of employee stock options and the purchase of common stock under our employee stock purchase plan.

We expect to continue our investing activities, including purchases of short-term investments and capital expenditures. Furthermore, cash reserves may be used to repurchase common stock under our stock repurchase programs or strategically acquire professional services firms that are complementary to our business.

The following schedule summarizes our principal contractual commitments as of December 29, 2006 (in thousands):

| <b>Fiscal year</b> | <b>Operating<br/>lease<br/>commitments</b> | <b>Capital<br/>leases</b> | <b>Purchase<br/>obligations</b> | <b>Total</b> |
|--------------------|--------------------------------------------|---------------------------|---------------------------------|--------------|
| 2007               | \$ 5,058                                   | \$ 94                     | \$ 383                          | \$ 5,535     |
| 2008               | 3,963                                      | 60                        |                                 | 4,023        |
| 2009               | 3,633                                      | 30                        |                                 | 3,663        |
| 2010               | 2,572                                      | 3                         |                                 | 2,575        |
| 2011               | 1,906                                      | 2                         |                                 | 1,908        |
| Thereafter         | 2,245                                      |                           |                                 | 2,245        |
|                    | \$ 19,377                                  | \$ 189                    | \$ 383                          | \$ 19,949    |

We have a revolving reducing mortgage note with a total available borrowing amount of \$17.4 million and an outstanding balance of \$0 as of February 23, 2007. We believe that our existing revolving note, together with funds generated from operations, will provide adequate cash to fund our anticipated cash needs through at least the next twelve-month period.

In addition, we believe that the funds available under the revolving reducing mortgage note, together with funds generated from operations, will provide adequate cash to fund our anticipated long-term cash needs beyond the next twelve-month period; however, we intend to grow our business by pursuing potential acquisitions, which could increase the need for additional sources of funds over the long-term.

As permitted under Delaware law, we have agreements whereby we indemnify our officers and directors for certain events or occurrences while the officer or director is, or was serving, at our request in such capacity. The indemnification period covers all pertinent events and occurrences during the officer's or director's lifetime. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited; however, we have director and officer insurance coverage that reduces our exposure and enables us to recover a portion of any future amounts paid. We believe the estimated fair value of these indemnification agreements in excess of applicable insurance coverage is minimal.

**Off-Balance Sheet Arrangements**

As part of our ongoing business, we do not engage in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities.

**Item 7A. Quantitative and Qualitative Disclosure About Market Risk**

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Exponent is exposed to interest rate risk associated with our balances of cash, cash equivalents and short-term investments. We manage our interest rate risk by maintaining an investment portfolio primarily consisting of debt instruments with high credit quality and relatively short average effective maturities in accordance with the Company's investment policy. The maximum effective maturity of any issue in our portfolio of cash equivalents and short-term investments is 3 years and the maximum average effective maturity of the portfolio cannot exceed 12 months.

Our exposure to market rate risk for changes in interest rates relates primarily to our short-term investments. We do not use derivative financial instruments in our short-term investment portfolio. The average effective maturity of our investment portfolio of short-term investments and cash equivalents at December 29, 2006 was 0.48 years.

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Notwithstanding our efforts to manage interest rate risk, there can be no assurances that we will be adequately protected against the risks associated with interest rate fluctuations.

We are exposed to some foreign currency exchange rate risk associated with our foreign operations. Given the limited nature of these operations, we believe that any exposure would be minimal.

Exponent has a revolving reducing mortgage note (the "Mortgage Note") secured by our Silicon Valley headquarters building. The Mortgage Note had an initial borrowing amount up to \$30.0 million and is subject to automatic annual reductions in the amount available to be borrowed of between approximately \$1.3 million to \$2.1 million per year until January 31, 2008. As of December 29, 2006 we had \$0 outstanding and available borrowings of \$19.4 million. As of February 23, 2007 our available borrowings under this note decreased to \$17.4 million due to the annual reductions in the amount available to be borrowed. The Mortgage Note is subject to two interest rate options of either prime less 1.5% or the fixed LIBOR plus 1.25% with a term of one month, two months, three months, six months, nine months, or twelve months.

Any borrowings under the Mortgage Note would expose us to some interest rate risk. Our general policy for selecting among interest rate options and related terms will be to minimize interest expense. However, given the risk of interest rate fluctuations, we cannot be certain that the lowest rate option will always be obtained, thereby consistently minimizing our interest expense. No sensitivity analysis was performed on our exposure to interest rate fluctuations, however, given the historical low volatility of both the prime and LIBOR interest rates, we believe that any exposure would be minimal.

### **Item 8. Financial Statements and Supplementary Data**

See Item 15 of this Form 10-K for required financial statements and supplementary data.

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

None.

### **Item 9A. Controls and Procedures**

#### **(a) Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures.**

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13(a)-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this annual report.

#### **(b) Management's Report on Internal Control Over Financial Reporting.**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13(a)-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control - Integrated Framework*, our management concluded that our internal control over financial reporting was effective as of December 29, 2006.

KPMG LLP, the independent registered public accounting firm that audited the Company's consolidated financial statements included in this Annual Report on Form 10-K, has issued a report on management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 29, 2006. The report on management's assessment and on the effectiveness of the Company's internal control over financial reporting as of December 29, 2006, is included in this Item under the heading "Report of Independent Registered Public Accounting Firm."

**(c) Changes in Internal Control Over Financial Reporting.**

There have not been any changes in the Company's internal control over financial reporting, as such term is defined in Rule 13a-15(f) under the Exchange Act, during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially effect, the Company's internal control over financial reporting.

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**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders

Exponent, Inc.:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, appearing under Item 9A(b), that Exponent, Inc. and subsidiaries maintained effective internal control over financial reporting as of December 29, 2006, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Management of Exponent, Inc. is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of Exponent, Inc.'s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Exponent, Inc. maintained effective internal control over financial reporting as of December 29, 2006, is fairly stated, in all material respects, based on criteria established in *Internal Control - Integrated Framework* issued by COSO. Also, in our opinion, Exponent, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 29, 2006, based on the criteria established in *Internal Control - Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Exponent, Inc. and subsidiaries as of December 29, 2006 and December 30, 2005, and the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for each of the years in the three-year period ended December 29, 2006, and our report dated March 7, 2007 expressed an unqualified opinion on those consolidated financial statements and the related financial statement schedule.

KPMG LLP

San Francisco, California

March 7, 2007

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**Item 9B. Other Information**

None.

**PART III**

**Item 10. Directors and Executive Officers of the Registrant**

The information required by this item with respect to our directors, code of ethics and compliance with section 16(a) of the Securities Exchange Act of 1934 is incorporated by reference to the sections of the Company's definitive Proxy Statement for its 2007 Annual Meeting of Stockholders (the "Proxy Statement") entitled "Proposal No. 1: Election of Directors," "Code of Business Conduct and Corporate Governance" and "Compliance with Section 16(a) of the Exchange Act." See Item 1 for information regarding the executive officers of the Company.

**Item 11. Executive Compensation**

The information required by this item is incorporated by reference to the section of the Proxy Statement entitled "Executive Officer Compensation."

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information required by this item is incorporated by reference to the sections of the Proxy Statement entitled "Stock Ownership" and "Equity Compensation Plan Information."

**Item 13. Certain Relationships and Related Transactions**

The information required by this item is incorporated by reference to the section of the Proxy Statement entitled "Related Party Transactions."

**Item 14. Principal Accounting Fees and Services**

The information required by this item is incorporated by reference to the section of the Proxy Statement entitled "Principal Accounting Fees and Services."

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### **PART IV**

#### **Item 15. Exhibits and Financial Statement Schedules**

(a) The following documents are filed as part of this Annual Report on Form 10-K.

##### **1. Financial Statements**

The following consolidated financial statements of Exponent, Inc. and subsidiaries and the Reports of Independent Registered Public Accounting Firm are included herewith:

|                                                                                                                                       |                   |
|---------------------------------------------------------------------------------------------------------------------------------------|-------------------|
| <u>Reports of Independent Registered Public Accounting Firm</u>                                                                       | <b>Page</b><br>27 |
| <u>Consolidated Statements of Income for the years ended December 29, 2006, December 30, 2005 and December 31, 2004</u>               | 28                |
| <u>Consolidated Balance Sheets as of December 29, 2006 and December 30, 2005</u>                                                      | 29                |
| <u>Consolidated Statements of Comprehensive Income for the years ended December 29, 2006, December 30, 2005 and December 31, 2004</u> | 30                |
| <u>Consolidated Statements of Stockholders' Equity for the years ended December 29, 2006, December 30, 2005 and December 31, 2004</u> | 31                |
| <u>Consolidated Statements of Cash Flows for the years ended December 29, 2006, December 30, 2005 and December 31, 2004</u>           | 33                |
| <u>Notes to Consolidated Financial Statements</u>                                                                                     | 34                |

##### **2. Financial Statement Schedules**

The following financial statement schedule of Exponent, Inc. for the years ended December 29, 2006, December 30, 2005 and December 31, 2004 is filed as part of this Report and should be read in conjunction with the Consolidated Financial Statements of Exponent, Inc.

|                                                        |                   |
|--------------------------------------------------------|-------------------|
| <u>Schedule II - Valuation and qualifying accounts</u> | <b>Page</b><br>54 |
|--------------------------------------------------------|-------------------|

Schedules other than those listed above have been omitted since they are either not required, not applicable, or the information is otherwise included elsewhere in the report.

##### **3. Exhibits**

|                          |                   |
|--------------------------|-------------------|
| (a) <u>Exhibit Index</u> | <b>Page</b><br>55 |
|--------------------------|-------------------|

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**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders

Exponent, Inc.:

We have audited the accompanying consolidated balance sheets of Exponent, Inc. and subsidiaries as of December 29, 2006 and December 30, 2005, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 29, 2006. In connection with our audits of the consolidated financial statements, we also have audited the accompanying financial statement schedule. These consolidated financial statements and financial statement schedule are the responsibility of the management of Exponent, Inc. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Exponent, Inc. and subsidiaries as of December 29, 2006 and December 30, 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 29, 2006, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 1 to the Consolidated Financial Statements, effective December 31, 2005, the Company adopted the provision of Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Exponent, Inc.'s internal control over financial reporting as of December 29, 2006, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 7, 2007 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

KPMG LLP

San Francisco, California

March 7, 2007

**Table of Contents****Exponent, Inc. and Subsidiaries****Consolidated Statements of Income**

| (In thousands, except per share data)  | 2006       | Fiscal Years<br>2005 | 2004       |
|----------------------------------------|------------|----------------------|------------|
| Revenues:                              |            |                      |            |
| Revenues before reimbursements         | \$ 156,742 | \$ 142,861           | \$ 138,718 |
| Reimbursements                         | 11,754     | 12,335               | 12,791     |
| Revenues                               | 168,496    | 155,196              | 151,509    |
| Operating expenses:                    |            |                      |            |
| Compensation and related expenses      | 105,860    | 93,963               | 90,760     |
| Other operating expenses               | 19,886     | 18,618               | 18,801     |
| Reimbursable expenses                  | 11,754     | 12,335               | 12,791     |
| General and administrative expenses    | 10,807     | 9,900                | 9,833      |
|                                        | 148,307    | 134,816              | 132,185    |
| Operating income                       | 20,189     | 20,380               | 19,324     |
| Other income:                          |            |                      |            |
| Interest income, net                   | 1,927      | 1,205                | 471        |
| Miscellaneous income, net              | 1,462      | 1,033                | 608        |
| Income before income taxes             | 23,578     | 22,618               | 20,403     |
| Provision for income taxes             | 9,384      | 8,432                | 8,363      |
| Net income                             | \$ 14,194  | \$ 14,186            | \$ 12,040  |
| Net income per share:                  |            |                      |            |
| Basic                                  | \$ 0.89    | \$ 0.88              | \$ 0.78    |
| Diluted                                | \$ 0.83    | \$ 0.81              | \$ 0.71    |
| Shares used in per share computations: |            |                      |            |
| Basic                                  | 15,883     | 16,212               | 15,414     |
| Diluted                                | 17,196     | 17,538               | 17,074     |

The accompanying notes are an integral part of the Consolidated Financial Statements.

**Table of Contents****Exponent, Inc. and Subsidiaries****Consolidated Balance Sheets**

| (In thousands, except per share data)                                                                    | Fiscal Years |            |
|----------------------------------------------------------------------------------------------------------|--------------|------------|
|                                                                                                          | 2006         | 2005       |
| <b>Assets</b>                                                                                            |              |            |
| Current assets:                                                                                          |              |            |
| Cash and cash equivalents                                                                                | \$ 5,238     | \$ 13,216  |
| Short-term investments                                                                                   | 52,844       | 55,682     |
| Accounts receivable, net of allowance for doubtful accounts of \$1,793 and \$1,222, respectively         | 48,208       | 46,211     |
| Prepaid expenses and other assets                                                                        | 3,484        | 2,900      |
| Deferred income taxes                                                                                    | 2,232        | 2,156      |
| Total current assets                                                                                     | 112,006      | 120,165    |
| Property, equipment and leasehold improvements, net                                                      | 29,577       | 29,839     |
| Goodwill                                                                                                 | 8,607        | 8,607      |
| Deferred income taxes                                                                                    | 4,602        | 1,648      |
| Other assets                                                                                             | 6,424        | 3,982      |
|                                                                                                          | \$ 161,216   | \$ 164,241 |
| <b>Liabilities and Stockholders' Equity</b>                                                              |              |            |
| Current liabilities:                                                                                     |              |            |
| Accounts payable and accrued liabilities                                                                 | \$ 4,887     | \$ 4,136   |
| Accrued payroll and employee benefits                                                                    | 21,773       | 19,910     |
| Deferred revenues                                                                                        | 4,066        | 2,364      |
| Total current liabilities                                                                                | 30,726       | 26,410     |
| Other liabilities                                                                                        | 142          | 101        |
| Deferred compensation                                                                                    | 4,946        | 3,386      |
| Deferred rent                                                                                            | 1,097        | 1,144      |
| Total liabilities                                                                                        | 36,911       | 31,041     |
| Commitments and contingencies                                                                            |              |            |
| Stockholders' equity:                                                                                    |              |            |
| Preferred stock, \$.001 par value; 5,000 shares authorized; no shares outstanding                        | 16           | 16         |
| Common stock, \$.001 par value; 100,000 shares authorized; 16,427 and 16,192 shares issued, respectively | 50,799       | 44,955     |
| Additional paid-in capital                                                                               | 93           | (93)       |
| Accumulated other comprehensive income                                                                   | 101,226      | 88,322     |
| Retained earnings                                                                                        | (27,829)     |            |
| Treasury stock, at cost: 1,714 and 0 shares held, respectively                                           |              |            |
| Total stockholders' equity                                                                               | 124,305      | 133,200    |
|                                                                                                          | \$ 161,216   | \$ 164,241 |

The accompanying notes are an integral part of the Consolidated Financial Statements.



**Table of Contents****Exponent, Inc. and Subsidiaries****Consolidated Statements of Comprehensive Income**

| (In thousands)                                                                         | Fiscal Years |           |           |
|----------------------------------------------------------------------------------------|--------------|-----------|-----------|
|                                                                                        | 2006         | 2005      | 2004      |
| Net income                                                                             | \$ 14,194    | \$ 14,186 | \$ 12,040 |
| Other comprehensive income (loss), net of tax:                                         |              |           |           |
| Foreign currency translation adjustments, net of tax                                   | 154          | (133)     | 57        |
| Unrealized gain (loss) arising during the period on short-term investments, net of tax | 32           | 5         | (77)      |
| Comprehensive income                                                                   | \$ 14,380    | \$ 14,058 | \$ 12,020 |

The accompanying notes are an integral part of the Consolidated Financial Statements.

**Table of Contents****Exponent, Inc. and Subsidiaries****Consolidated Statements of Stockholders Equity**

| (In thousands)                                        | Common Stock |        |                                  | Accumulated<br>other<br>comprehensive<br>income<br>(loss) | Retained<br>earnings | Treasury Stock |            | Total     |
|-------------------------------------------------------|--------------|--------|----------------------------------|-----------------------------------------------------------|----------------------|----------------|------------|-----------|
|                                                       | Shares       | Amount | Additional<br>paid-in<br>capital |                                                           |                      | Shares         | Amount     |           |
| Balance at January 2, 2004                            | 15,986       | \$ 16  | \$ 36,220                        | \$ 94                                                     | \$ 64,237            | 1,390          | \$ (5,449) | \$ 95,118 |
| Employee stock purchase plan                          | 26           |        | 1,014                            |                                                           |                      | (148)          | 494        | 1,508     |
| Exercise of stock options, net of swaps               |              |        |                                  |                                                           | (752)                | (1,242)        | 4,955      | 4,203     |
| Tax benefit for stock option plans                    |              |        | 2,864                            |                                                           |                      |                |            | 2,864     |
| Amortization of unrecognized stock-based compensation |              |        | 256                              |                                                           |                      |                |            | 256       |
| Foreign currency translation adjustments              |              |        |                                  | 97                                                        |                      |                |            | 97        |
| Issuance of restricted stock units                    |              |        | 985                              |                                                           |                      |                |            | 985       |
| Unrealized loss on investments                        |              |        |                                  | (77)                                                      |                      |                |            | (77)      |
| Other                                                 |              |        | 28                               |                                                           |                      |                |            | 28        |
| Net income                                            |              |        |                                  |                                                           | 12,040               |                |            | 12,040    |
| Balance at December 31, 2004                          | 16,012       | 16     | 41,367                           | 114                                                       | 75,525               |                |            | 117,022   |
| Employee stock purchase plan                          | 76           |        | 773                              |                                                           | (50)                 | (86)           | 1,037      | 1,760     |
| Exercise of stock options, net of swaps               | 104          |        | (192)                            |                                                           | (1,339)              | (276)          | 3,270      | 1,739     |
| Tax benefit for stock option plans                    |              |        | 1,068                            |                                                           |                      |                |            | 1,068     |
| Amortization of unrecognized stock-based compensation |              |        | 604                              |                                                           |                      |                |            | 604       |
| Purchase of treasury shares                           |              |        |                                  |                                                           |                      | 362            | (4,307)    | (4,307)   |
| Foreign currency translation adjustments              |              |        |                                  | (212)                                                     |                      |                |            | (212)     |
| Issuance of restricted stock units                    |              |        | 1,342                            |                                                           |                      |                |            | 1,342     |
| Unrealized gain on investments                        |              |        |                                  | 5                                                         |                      |                |            | 5         |
| Other                                                 |              |        | (7)                              |                                                           |                      |                |            | (7)       |
| Net income                                            |              |        |                                  |                                                           | 14,186               |                |            | 14,186    |
| Balance at December 30, 2005                          | 16,192       | 16     | 44,955                           | (93)                                                      | 88,322               |                |            | 133,200   |

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|                                                       | Common Stock |        | Additional         |    | Accumulated<br>other<br>comprehensive<br>income<br>(loss) | Retained<br>earnings | Treasury Stock |             | Total      |
|-------------------------------------------------------|--------------|--------|--------------------|----|-----------------------------------------------------------|----------------------|----------------|-------------|------------|
| (In thousands)                                        | Shares       | Amount | paid-in<br>capital |    |                                                           |                      | Shares         | Amount      |            |
| Balance at December 30, 2005                          | 16,192       | 16     | 44,955             |    | (93)                                                      | 88,322               |                |             | 133,200    |
| Employee stock purchase plan                          | 14           |        | 231                |    |                                                           | (10)                 | (35)           | 566         | 787        |
| Exercise of stock options, net of swaps               | 221          |        | 1,097              |    |                                                           | (1,280)              | (104)          | 1,695       | 1,512      |
| Tax benefit for stock option plans                    |              |        | 869                |    |                                                           |                      |                |             | 869        |
| Amortization of unrecognized stock-based compensation |              |        | 2,197              |    |                                                           |                      |                |             | 2,197      |
| Purchase of treasury shares                           |              |        |                    |    |                                                           |                      | 1,853          | (30,090)    | (30,090)   |
| Foreign currency translation adjustments              |              |        |                    |    | 154                                                       |                      |                |             | 154        |
| Issuance of restricted stock units                    |              |        | 1,450              |    |                                                           |                      |                |             | 1,450      |
| Unrealized gain on investments                        |              |        |                    |    | 32                                                        |                      |                |             | 32         |
| Net income                                            |              |        |                    |    |                                                           | 14,194               |                |             | 14,194     |
| Balance at December 29, 2006                          | 16,427       | \$ 16  | \$ 50,799          | \$ | 93                                                        | \$ 101,226           | 1,714          | \$ (27,829) | \$ 124,305 |

The accompanying notes are an integral part of the Consolidated Financial Statements.

**Table of Contents****Exponent, Inc. and Subsidiaries****Consolidated Statements of Cash Flows**

| (In thousands)                                                                    | 2006      | Fiscal Years<br>2005 | 2004      |
|-----------------------------------------------------------------------------------|-----------|----------------------|-----------|
| Cash flows from operating activities:                                             |           |                      |           |
| Net income                                                                        | \$ 14,194 | \$ 14,186            | \$ 12,040 |
| Adjustments to reconcile net income to net cash provided by operating activities: |           |                      |           |
| Depreciation and amortization of property, equipment and leasehold improvements   | 3,628     | 3,432                | 3,285     |
| Amortization of premiums and accretion of discounts of short-term investments     | 532       | 1,040                | 803       |
| Contribution to deferred compensation plan                                        | (1,000)   |                      |           |
| Amortization of deferred compensation contribution                                | 314       |                      |           |
| Deferred rent expense                                                             | (47)      | 57                   | 56        |
| Provision for doubtful accounts                                                   | 1,634     | 1,158                | 1,846     |
| Stock-based compensation                                                          | 4,414     | 2,055                | 1,596     |
| Deferred income tax provision                                                     | (3,158)   | (1,477)              | (1,443)   |
| Tax benefit for stock option plans                                                | (869)     | 1,068                | 2,864     |
| Changes in operating assets and liabilities:                                      |           |                      |           |
| Accounts receivable                                                               | (3,631)   | (8,783)              | (4,588)   |
| Prepaid expenses and other assets                                                 | (791)     | (684)                | (369)     |
| Accounts payable and accrued liabilities                                          | 1,564     | (194)                | (513)     |
| Accrued payroll and employee benefits                                             | 1,096     | 1,274                | 1,644     |
| Deferred revenues                                                                 | 1,702     | 683                  | (1,183)   |
| Net cash provided by operating activities                                         | 19,582    | 13,815               | 16,038    |
| Cash flows from investing activities:                                             |           |                      |           |
| Capital expenditures                                                              | (3,205)   | (3,015)              | (2,616)   |
| Other assets                                                                      | 57        | 8                    | 264       |
| Purchase of short-term investments                                                | (117,569) | (82,435)             | (76,620)  |
| Sale/maturity of short-term investments                                           | 119,922   | 81,095               | 56,256    |
| Net cash used in investing activities                                             | (795)     | (4,347)              | (22,716)  |
| Cash flows from financing activities:                                             |           |                      |           |
| Repayments of borrowings                                                          | (52)      | (61)                 | (65)      |
| Tax benefit for stock option plans                                                | 869       |                      |           |
| Repurchase of common stock                                                        | (30,090)  | (4,307)              |           |
| Issuance of treasury stock                                                        | 986       | 2,174                | 4,697     |
| Issuance of common stock                                                          | 1,313     | 1,325                | 1,014     |
| Net cash (used in) provided by financing activities                               | (26,974)  | (869)                | 5,646     |
| Effect of foreign currency exchange rates on cash and cash equivalents            | 209       | (63)                 | 46        |
| Net (decrease) increase in cash and cash equivalents                              | (7,978)   | 8,536                | (986)     |
| Cash and cash equivalents at beginning of year                                    | 13,216    | 4,680                | 5,666     |
| Cash and cash equivalents at end of year                                          | \$ 5,238  | \$ 13,216            | \$ 4,680  |

The accompanying notes are an integral part of the Consolidated Financial Statements.



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### **Exponent, Inc. and Subsidiaries**

### **Notes to Consolidated Financial Statements**

#### **Note 1: Summary of Significant Accounting Policies**

##### **Basis of Presentation**

Exponent, Inc. together with its subsidiaries (referred to as the "Company") is a science and engineering consulting firm that provides solutions to complex problems. The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant inter-company transactions and balances have been eliminated in consolidation.

The Company operates on a 52-53 week fiscal year with each year ending on the Friday closest to December 31<sup>st</sup>. Fiscal periods 2006, 2005 and 2004 included 52 weeks of activity and ended on December 29, 2006, December 30, 2005 and December 31, 2004, respectively.

##### **Stock Split**

On May 24, 2006, the Company's stockholders approved an amendment to the Company's certificate of incorporation to (i) increase the number of authorized shares of common stock to 100,000,000, (ii) increase the number of authorized shares of preferred stock to 5,000,000, and (iii) effect a two-for-one stock split. As a result of the stock split, each shareholder of record at the close of business on May 24, 2006, received one additional share of common stock for each share held. For periods prior to the stock split, all share and per share data in the Company's condensed consolidated financial statements and related notes have been retroactively adjusted to reflect the stock split.

The Company committed to stockholders in a letter dated May 23, 2006 to limit its use of the increased authorized capital stock to 40 million common shares, and 2 million preferred shares, unless the approval of the Company's stockholders is obtained subsequently, such as through a further amendment to the Company's authorized capital stock.

##### **Revenue Recognition**

The Company derives its revenues primarily from professional fees earned on consulting engagements and fees earned for the use of its equipment and facilities, as well as reimbursements for outside direct expenses associated with the services that are billed to its clients.

Exponent reports revenues net of subcontractor fees. The Company has determined that it is not the primary obligor with respect to its subcontractors because:

its clients are directly involved in the subcontractor selection process;

the subcontractor is responsible for fulfilling the scope of work; and

the Company passes through the costs of subcontractor agreements with only a minimal fixed percentage mark-up to compensate it for processing the transactions.

Reimbursements, including those related to travel and other out-of-pocket expenses, and other similar third party costs such as the cost of materials, are included in revenues, and an equivalent amount of reimbursable expenses are included in operating expenses. Any mark-up on reimbursable expenses is included in revenues.

Substantially all of the Company's 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 the Company's fixed-price engagements, it recognizes revenue based on the relationship of incurred labor hours at standard rates to its estimate of the total labor hours at

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standard rates it expects to incur over the term of the contract. The Company believes this methodology achieves a reliable measure of the revenue from the consulting services it provides to its customers under fixed-price contracts given the nature of the consulting services the Company provides and the following additional considerations:

the Company considers labor hours at standard rates and expenses to be incurred when pricing its contracts;

the Company generally does not incur set up costs on its contracts;

the Company does not believe that there are reliable milestones to measure progress toward completion;

if the contract is terminated early, the customer is required to pay the Company for time at standard rates plus materials incurred to date;

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the Company does not recognize revenue for award fees or bonuses until specific contractual criteria are met;

the Company does not include revenue for unpriced change orders until the customer agrees with the changes;

historically the Company has not had significant accounts receivable write-offs or cost overruns; and

its contracts are typically progress billed on a monthly basis.

Gross revenues and reimbursements for the fiscal years ended December 29, 2006, December 30, 2005 and December 31, 2004, respectively, were:

| (In thousands)                      | Fiscal Years |            |            |
|-------------------------------------|--------------|------------|------------|
|                                     | 2006         | 2005       | 2004       |
| Gross revenues                      | \$ 173,084   | \$ 167,994 | \$ 158,445 |
| Less: Subcontractor fees            | 4,588        | 12,798     | 6,936      |
| Revenues                            | 168,496      | 155,196    | 151,509    |
| Reimbursements:                     |              |            |            |
| Out-of-pocket travel reimbursements | 4,548        | 3,989      | 3,798      |
| Other outside direct expenses       | 7,206        | 8,346      | 8,993      |
|                                     | 11,754       | 12,335     | 12,791     |
| Revenues before reimbursements      | \$ 156,742   | \$ 142,861 | \$ 138,718 |

Significant management judgments and estimates must be made 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 the Company made different judgments or utilized different estimates, the amount and timing of its 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, the Company determines that collection of revenue is not reasonably assured, it does not recognize the revenue until its collection becomes reasonably assured, which is generally upon receipt of cash. The Company assesses 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.

**Use of Estimates**

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

**Reclassifications**

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Certain prior period balances have been reclassified to conform to the current period presentation. In connection with the adoption of SFAS 123(R) the prior period balances for deferred stock-based compensation and stock-based compensation expense were reclassified.

### Foreign Currency Translation

The Company translates the assets and liabilities of foreign subsidiaries, whose functional currency is the local currency, at exchange rates in effect at the balance sheet date. Revenues and expenses are translated at the average rates of exchange prevailing during the year. The adjustment resulting from translating the financial statements of such foreign subsidiaries is included in accumulated other comprehensive income, which is reflected as a separate component of stockholders' equity.

### Cash Equivalents

Cash equivalents consist of highly liquid investments such as money market mutual funds, commercial paper and debt securities with original maturities of three months or less.

### Short-Term Investments

Short-term investments consist of debt securities classified as available-for-sale and are carried at their fair value as of the balance sheet date. Short-term investments generally mature between three months and three years from the purchase date. Investments with maturities beyond one year are classified as short-term based on their highly liquid nature and because such marketable securities represent investments readily available for current operations. The amortized cost of securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization is included in interest income. Realized gains or losses are determined on the specific identification method and are reflected in other income. Net unrealized gains and losses are

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recorded directly in accumulated other comprehensive income except for unrealized losses that are deemed to be other-than-temporary, which are reflected in net income.

Short-term investments are reviewed on a regular basis to evaluate whether or not any security has experienced an other-than temporary decline in fair value. When assessing short-term investments for other-than-temporary declines in fair value, the Company considers the significance of the decline in value as a percentage of the original cost, how long the market value of the investment has been less than its original cost, and any news that has been released specific to the investee.

### **Allowances for Doubtful Accounts**

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of customers to meet their financial obligations. In circumstances where the Company is aware of a specific customer's inability to meet its financial obligations a specific allowance is recorded to reduce the net recognized receivable to the amount the Company reasonably believes will be collected. For all other customers the Company recognizes allowances for doubtful accounts based upon historical bad debts, customer concentration, customer credit-worthiness, current economic conditions and changes in customer payment terms.

### **Property, Equipment and Leasehold Improvements**

Property, equipment and leasehold improvements are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are recognized using the straight-line method. Buildings are depreciated over their estimated useful lives ranging from thirty to forty years. Equipment is depreciated over its estimated useful life, which generally ranges from two to seven years. Leasehold improvements are amortized over the shorter of their estimated useful lives, generally seven years, or the term of the related lease.

### **Impairment of Long-Lived Assets**

The Company evaluates long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to future cash flows to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets

exceeds the fair value of the assets. The Company has not recognized impairment losses on any long-lived assets in fiscal 2006, 2005 or 2004.

### **Goodwill and Other Intangible Assets**

The Company assesses the impairment of goodwill annually and whenever events or changes in circumstances indicate that the carrying amount may be impaired. The Company's annual goodwill impairment review is completed at the end of the 47<sup>th</sup> week of each fiscal year. The Company assesses the impairment of intangible assets that are subject to amortization in accordance with SFAS No. 144 *Accounting for the Impairment or Disposal of Long-lived Assets*, whenever events or changes in circumstances indicate that the carrying value may be impaired. Factors that the Company considers 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 use of the acquired assets or the strategy for overall business; and

significant negative economic trends.

When evaluating the Company's goodwill for impairment, based upon the existence of one or more of the above factors, the Company determines 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, 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. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation, in accordance with FASB Statement No. 141, *Business Combinations*. The residual fair value after this allocation is the implied value of the reporting unit

goodwill.

When determining whether the carrying value of amortizable intangible assets is impaired, based upon the existence of one or more of the above factors, the Company compares the carrying amount of the asset to the undiscounted future cash flows to be generated by the asset. If such cash flows are less than the carrying amount, the assets are tested for impairment. The impairment is measured and recognized as the amount by which the carrying value of the assets exceeds the fair value of the assets.

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### **Deferred Revenues**

Deferred revenues represent amounts billed to clients in advance of services provided, primarily on fixed-price projects. The Company had \$4,066,000 and \$2,364,000 in deferred revenues as of December 29, 2006 and December 30, 2005, respectively.

### **Income Taxes**

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax basis and the financial reporting basis of assets and liabilities. Deferred tax assets and liabilities are measured using the enacted tax rates and laws in effect when the differences are expected to reverse. The effect on deferred tax assets and liabilities from changes in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is recorded for deferred tax assets if it is more likely than not that some portion or all of the deferred tax assets will not be realized.

### **Fair Value of Financial Instruments**

Financial instruments consist of cash and cash equivalents, short-term investments, accounts receivable, other assets and accounts payable. The carrying amount of the Company's cash and cash equivalents, short-term investments, accounts receivable, other assets and accounts payable approximates their fair values.

### **Stock-Based Compensation**

During the first quarter of fiscal 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS 123(R)), which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors including employee stock options and restricted stock unit grants based on estimated fair values. SFAS 123(R) supersedes the Company's previous accounting under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees and amends Statement of Financial Accounting Standards No. 95, Statement of Cash Flows. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 (SAB 107) relating to SFAS 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R).

Stock-based compensation is measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the requisite service period. The Company elected

the modified-prospective method of adoption, under which prior periods are not revised for comparative purposes. Under this transition method of adoption, stock-based compensation expense for 2006 includes compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of December 30, 2005, based on the grant-date fair value estimated in accordance with the original provision of SFAS 123. Stock-based compensation expense for all stock-based compensation awards granted or modified after December 30, 2005 is based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R).

SFAS 123(R) requires that the benefits of tax deductions in excess of recognized compensation cost be reported as a financing cash flow, rather than as an operating cash flow. As a result, the adoption of SFAS 123(R) reduces net operating cash flows and increases net financing cash flows in the periods after the effective date. Total cash flow will remain unchanged from what would have been reported. Pursuant to the income tax provisions included in SFAS 123(R), the Company has elected the short-cut method of computing our hypothetical additional paid-in capital pool. SFAS 123(R) also requires that the Company estimate the number of awards that are expected to vest and to revise the estimate as actual forfeitures differ from that estimate. Previously, the Company accounted for forfeitures under the provisions of SFAS 123, wherein the Company recognized forfeitures as they occurred. The Company estimated the forfeiture rate for 2006 based on its historical experience.

As a result of adopting SFAS 123(R), the Company's income before income taxes and net income for fiscal 2006 were \$1.2 million and \$850,000 lower, respectively. Income taxes for fiscal 2006 were \$358,000 lower due to the adoption of SFAS 123(R). The impact on both basic and diluted earnings per share for the year ended December 29, 2006 was a decrease of \$0.05 per share. See Note 9 for further information regarding the Company's stock-based compensation assumptions and expenses, including pro-forma disclosures for prior periods as if the Company had recorded stock-based compensation expense.

### **Net Income Per Share**

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Basic per share amounts are computed using the weighted-average number of common shares outstanding during the period. Dilutive per share amounts are computed using the weighted-average number of common shares outstanding and potentially dilutive securities, using the treasury stock method if their effect would be dilutive.

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The following schedule reconciles the denominators of the Company's calculation for basic and diluted net income per share:

| (In thousands)                                          | Fiscal Years |        |        |
|---------------------------------------------------------|--------------|--------|--------|
|                                                         | 2006         | 2005   | 2004   |
| Shares used in basic per share computation              | 15,883       | 16,212 | 15,414 |
| Effect of dilutive common stock options outstanding     | 1,143        | 1,268  | 1,632  |
| Effect of non-vested restricted stock units outstanding | 170          | 58     | 28     |
| Shares used in diluted per share computation            | 17,196       | 17,538 | 17,074 |

There were no options excluded from the diluted per share calculation for the fiscal year ended December 29, 2006. Common stock options to purchase 5,000 shares were excluded from the diluted per share calculation for the fiscal year ended December 30, 2005 due to their antidilutive effect. There were no options excluded from the diluted per share calculation for the fiscal year ended December 31, 2004.

**Recent Accounting Pronouncements**

In September 2006, the Securities and Exchange Commission (SEC) issued SAB No. 108 – Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements, which provides interpretive guidance on how registrants should quantify financial statement misstatements. Under SAB 108 registrants are required to consider both a rollover method which focuses primarily on the income statement impact of misstatements and the iron curtain method which focuses primarily on the balance sheet impact of misstatements. The transition provisions of SAB 108 permit a registrant to adjust retained earnings for the cumulative effect of immaterial errors relating to prior years. The Company was required to adopt SAB 108 in fiscal 2006. The adoption of SAB 108 did not have an impact on the Company's consolidated financial position, results of operations or cash flows.

**Table of Contents****Note 2: Cash, cash equivalents and short-term investments**

Cash, cash equivalents and short-term investments consisted of the following as of December 29, 2006:

| (In thousands)                                          | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Estimated<br>Fair Value |
|---------------------------------------------------------|-------------------|---------------------|----------------------|-------------------------|
| Classified as current assets:                           |                   |                     |                      |                         |
| Cash                                                    | \$ 4,775          | \$                  | \$                   | \$ 4,775                |
| Cash equivalents:                                       |                   |                     |                      |                         |
| Money market securities                                 | 463               |                     |                      | 463                     |
| Total cash equivalents                                  | 463               |                     |                      | 463                     |
| Total cash and cash equivalents                         | 5,238             |                     |                      | 5,238                   |
| Short-term investments:                                 |                   |                     |                      |                         |
| State and municipal bonds                               | 52,903            | 11                  | (70)                 | 52,844                  |
| Total short-term investments                            | 52,903            | 11                  | (70)                 | 52,844                  |
| Total cash, cash equivalents and short-term investments | \$ 58,141         | \$ 11               | \$ (70)              | \$ 58,082               |

Cash, cash equivalents and short-term investments consisted of the following as of December 30, 2005:

| (In thousands)                                          | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Estimated<br>Fair Value |
|---------------------------------------------------------|-------------------|---------------------|----------------------|-------------------------|
| Classified as current assets:                           |                   |                     |                      |                         |
| Cash                                                    | \$ 3,355          | \$                  | \$                   | \$ 3,355                |
| Cash equivalents:                                       |                   |                     |                      |                         |
| Money market securities                                 | 161               |                     |                      | 161                     |
| Commercial paper                                        | 9,700             |                     |                      | 9,700                   |
| Total cash equivalents                                  | 9,861             |                     |                      | 9,861                   |
| Total cash and cash equivalents                         | 13,216            |                     |                      | 13,216                  |
| Short-term investments:                                 |                   |                     |                      |                         |
| State and municipal bonds                               | 55,789            | 3                   | (110)                | 55,682                  |
| Total short-term investments                            | 55,789            | 3                   | (110)                | 55,682                  |
| Total cash, cash equivalents and short-term investments | \$ 69,005         | \$ 3                | \$ (110)             | \$ 68,898               |

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In accordance with EITF 03-1, the following table summarizes the fair value and gross unrealized losses related to available-for-sale securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 29, 2006:

| (in thousands)            | Less than 12 Months |                         | 12 Months or More |                         | Total      |                         |
|---------------------------|---------------------|-------------------------|-------------------|-------------------------|------------|-------------------------|
|                           | Fair Value          | Gross Unrealized Losses | Fair Value        | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| State and municipal bonds | \$ 10,867           | \$ (43)                 | \$ 10,117         | \$ (27)                 | \$ 20,984  | \$ (70)                 |

Market values were determined for each individual security in the investment portfolio. The declines in value of these investments are primarily related to changes in interest rates and are considered to be temporary in nature. All cash equivalents and short-term investments had effective maturities of three years or less, with an average effective maturity of 0.48 years as of December 29, 2006.

**Note 3: Property, Equipment and Leasehold Improvements**

| (In thousands)                                      | Fiscal Years |           |
|-----------------------------------------------------|--------------|-----------|
|                                                     | 2006         | 2005      |
| Property:                                           |              |           |
| Land                                                | \$ 4,450     | \$ 4,450  |
| Buildings                                           | 32,687       | 32,671    |
| Construction in progress                            | 681          | 400       |
| Equipment:                                          |              |           |
| Machinery and equipment                             | 20,468       | 18,992    |
| Office furniture and equipment                      | 5,768        | 5,257     |
| Leasehold improvements                              | 6,689        | 6,297     |
|                                                     | 70,743       | 68,067    |
| Less accumulated depreciation and amortization      | 41,166       | 38,228    |
| Property, equipment and leasehold improvements, net | \$ 29,577    | \$ 29,839 |

Depreciation and amortization for the fiscal years ended December 29, 2006, December 30, 2005 and December 31, 2004, was \$3,614,000, \$3,398,000 and \$3,232,000, respectively.

**Table of Contents****Note 4: Goodwill**

Below is a breakdown of goodwill, reported by segment as of December 29, 2006:

| (In thousands) | Environmental<br>and health | Engineering and<br>other scientific | Total    |
|----------------|-----------------------------|-------------------------------------|----------|
| Goodwill       | \$ 8,099                    | \$ 508                              | \$ 8,607 |

There were no changes in the carrying amount of goodwill for the year ended December 29, 2006. There were no goodwill impairments or gains or losses on disposals for any portion of the Company's reporting units during the year ended December 29, 2006.

**Note 5: Long-term Obligations**

| (In thousands)                                | Fiscal Years |        |
|-----------------------------------------------|--------------|--------|
|                                               | 2006         | 2005   |
| Capital leases                                | \$ 177       | \$ 112 |
| Other                                         | 45           | 41     |
|                                               | 222          | 153    |
| Less current installments                     | 80           | 52     |
| Long-term obligations, net of current portion | \$ 142       | \$ 101 |

Principal payments due on capital lease obligations are \$80,000, \$63,000, \$29,000, \$3,000 and \$2,000 in fiscal 2007 through fiscal 2011, respectively, and \$0 thereafter. See Note 11 for information regarding the Company's deferred compensation plan.

The Company has a revolving reducing mortgage note (the Mortgage Note) secured by its Silicon Valley headquarters building. The Mortgage Note, which had an initial borrowing amount up to \$30,000,000, is subject to automatic annual reductions in the amount available to be borrowed of between \$1,250,000 to \$2,053,000 per year until January 31, 2008, as scheduled in the Mortgage Note agreement. As of December 29, 2006, \$19,378,000 was available to be borrowed and the outstanding balance was \$0. Any outstanding amounts on the Mortgage Note are due and payable in full on January 31, 2009. The Company may from time to time during the term of the Mortgage Note borrow, partially or wholly repay its outstanding borrowings and re-borrow up to the maximum principal amounts, subject to the reductions in availability contained in the note. The Mortgage Note is also subject to two interest rate options of either prime less 1.5% (6.75% at December 29, 2006) or the fixed LIBOR plus 1.25% (6.59% at December 29, 2006) with a term option of one month, two months, three months, six months, nine months, or twelve months. Interest will be paid on a monthly basis. Principal amounts subject to the prime interest rate may be repaid at any time without penalty.

Principal amounts subject to the fixed LIBOR rate may also be repaid at any time but are subject to a prepayment penalty if paid before the fixed rate term, or additional interest if paid after the fixed rate term.

**Note 6: Other Significant Balance Sheet Components****Account receivable, net**

| (In thousands) | Fiscal Years |      |
|----------------|--------------|------|
|                | 2006         | 2005 |

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|                                 |           |           |
|---------------------------------|-----------|-----------|
| Billed accounts receivable      | \$ 32,527 | \$ 32,482 |
| Unbilled accounts receivable    | 17,474    | 14,951    |
| Allowance for doubtful accounts | (1,793)   | (1,222)   |
| Total accounts receivable, net  | \$ 48,208 | \$ 46,211 |

## Accounts payable and accrued liabilities

| (In thousands)                                       | Fiscal Years |          |
|------------------------------------------------------|--------------|----------|
|                                                      | 2006         | 2005     |
| Accounts payable                                     | \$ 2,855     | \$ 3,013 |
| Accrued liabilities                                  | 2,032        | 1,123    |
| Total accounts payable and other accrued liabilities | \$ 4,887     | \$ 4,136 |

## Accrued payroll and employee benefits

| (In thousands)                              | Fiscal Years |           |
|---------------------------------------------|--------------|-----------|
|                                             | 2006         | 2005      |
| Accrued bonuses payable                     | \$ 11,491    | \$ 10,838 |
| Accrued 401(k) contributions                | 4,790        | 4,148     |
| Accrued vacation                            | 4,568        | 4,093     |
| Other accrued payroll and employee benefits | 924          | 831       |
| Total accrued payroll and employee benefits | \$ 21,773    | \$ 19,910 |

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Other accrued payroll and employee benefits consist primarily of accrued wages, payroll taxes and disability insurance programs.

### Note 7: Income Taxes

Total income tax expense for the fiscal years ended December 29, 2006, December 30, 2005 and December 31, 2004 consisted of the following:

| (In thousands) | 2006      | Fiscal Years<br>2005 | 2004     |
|----------------|-----------|----------------------|----------|
| Current        |           |                      |          |
| Federal        | \$ 10,154 | \$ 7,950             | \$ 8,039 |
| State          | 2,387     | 1,959                | 1,767    |
|                | 12,541    | 9,909                | 9,806    |
| Deferred       |           |                      |          |
| Federal        | (2,567)   | (1,204)              | (1,184)  |
| State          | (590)     | (273)                | (259)    |
|                | (3,157)   | (1,477)              | (1,443)  |
| Total          | \$ 9,384  | \$ 8,432             | \$ 8,363 |

The Company's effective tax rate differs from the statutory federal tax rate of 35% as shown in the following schedule:

| (In thousands)                          | 2006     | Fiscal Years<br>2005 | 2004     |
|-----------------------------------------|----------|----------------------|----------|
| Tax at federal statutory rate           | \$ 8,252 | \$ 7,916             | \$ 7,141 |
| State taxes, net of federal benefit     | 1,168    | 1,094                | 983      |
| Tax exempt interest income              | (654)    | (424)                | (165)    |
| Non-deductible expenses                 | 190      | 177                  | 172      |
| Non-deductible stock-based compensation | 110      |                      |          |
| Other                                   | 318      | (331)                | 232      |
| Tax expense                             | \$ 9,384 | \$ 8,432             | \$ 8,363 |
| Effective tax rate                      | 39.8%    | 37.3%                | 41.0%    |

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 29, 2006 and December 30, 2005 are presented in the following schedule:

| (In thousands)                                 | 2006     | Fiscal Years<br>2005 |
|------------------------------------------------|----------|----------------------|
| Deferred tax assets:                           |          |                      |
| Deferred compensation                          | \$ 3,247 | \$ 1,788             |
| Accrued liabilities and allowances             | 5,307    | 3,961                |
| Property, equipment and leasehold improvements | 242      |                      |
| Other                                          | 55       | 138                  |

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|                                                |          |          |
|------------------------------------------------|----------|----------|
| Total deferred tax assets                      | 8,851    | 5,887    |
| Deferred tax liabilities:                      |          |          |
| State taxes                                    | (448)    | (241)    |
| Deductible goodwill                            | (1,411)  | (1,142)  |
| Property, equipment and leasehold improvements |          | (696)    |
| Other                                          | (158)    | (4)      |
| Total deferred tax liabilities                 | (2,017)  | (2,083)  |
| Net deferred tax assets                        | \$ 6,834 | \$ 3,804 |

Management believes it is more likely than not that the results of future operations will generate sufficient taxable income to realize the net deferred tax assets.

The Company is entitled to a deduction for federal and state tax purposes with respect to employees' stock option activity. The net deduction in taxes otherwise payable arising from that deduction has been credited to additional paid-in capital. For the fiscal years ended December 29, 2006, December 30, 2005 and December 31, 2004 the net deduction in tax payable arising from employees' stock option activity was \$869,000, \$1,068,000 and \$2,864,000 respectively.

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**Note 8: Stockholders' Equity**

**Preferred Stock**

The Board of Directors has the authority to issue up to 5,000,000 shares of preferred stock in one or more series and to fix the rights, preferences, privileges and restrictions of the shares, including dividend rights, conversion rights, voting rights, terms of redemption and liquidation preferences. There are no shares of preferred stock outstanding.

**Accumulated Other Comprehensive Income**

Accumulated other comprehensive income consists of cumulative foreign currency translation adjustments and unrealized gains or losses on short-term investments.

**Treasury Stock**

Net losses related to the re-issuance of treasury stock of \$1,290,000, \$1,389,000 and \$752,000 were recorded as a reduction to retained earnings during fiscal 2006, 2005 and 2004, respectively.

**Repurchase of Common Stock**

On April 4, 2006, the Company's Board of Directors authorized an additional \$35 million for stock repurchases. The Company repurchased 1,853,000 shares of its common stock for \$30.1 million during the twelve months ended December 29, 2006. The Company repurchased 362,000 shares of its common stock for \$4.3 million during the twelve months ended December 30, 2005. As of December 29, 2006, the Company had remaining authorization under its stock repurchase plan of \$5.3 million to repurchase shares of common stock.

**Note 9: Stock-Based Compensation**

**Employee Stock Purchase Plan**

The Company authorized 800,000 shares of common stock for issuance under the original 1992 Employee Stock Purchase Plan (The Purchase Plan). All shares initially authorized under the Purchase Plan were distributed by the second quarter of fiscal 1999. At the 1999 Stockholders Meeting an amendment to the Purchase Plan was approved. This amendment authorized an additional 800,000 shares for distribution and also inserted a clause in the Purchase Plan that states that an annual increase can be added on each anniversary date of the adoption of the Plan equal to the lesser of: 400,000 shares, 3% of outstanding shares on such date or an amount determined by the Board of Directors. The Board of Directors did not approve an increase to this plan in 2006 and 2005. The Board of Directors approved an increase to this plan of 370,000 shares in 2004.

Qualified employees may elect to have a certain percentage (not to exceed 15%) of their salary withheld for purchase of stock pursuant to this plan. The Purchase Plan allows employees to purchase Company shares at 95% of the fair market value of the common stock on the date of purchase. As of December 29, 2006, 2,044,303 shares have been sold and 1,135,697 shares were available for issuance under the Purchase Plan. Weighted average purchase prices for shares sold under the plan in fiscal 2006, 2005 and 2004 were \$16.06, \$10.91 and \$8.68, respectively.

**Restricted Stock Plan**

The Restricted Stock Plan was approved at the 1999 Stockholders Meeting. The terms of the restrictions are to be determined by the Board of Directors upon grant. This plan initially provided for 200,000 shares to be available for grant and includes a clause which states that an annual increase can be added on each anniversary date of the adoption of the plan equal to the lesser of: 400,000 shares, 2% of outstanding shares on such date or a lesser amount determined by the Board of Directors. The Board of Directors approved increases of 320,000 shares, 320,000 shares and 304,000 shares in 2006, 2005 and 2004, respectively. As of December 29, 2006, 654,352 awards have been granted under the 1999 Restricted Stock Plan, 322,118 of which are outstanding.



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Activity under the Restricted Stock Plan is as follows<sup>1</sup>:

|                                 | Awards<br>available<br>for grant | Number of<br>awards<br>outstanding | Weighted-<br>average<br>fair value |
|---------------------------------|----------------------------------|------------------------------------|------------------------------------|
| Balance as of January 2, 2004   | 1,272,000                        |                                    | \$                                 |
| Awards granted                  | (185,128)                        | 185,128                            | 11.45                              |
| Awards vested                   |                                  | (86,546)                           | 11.38                              |
| Awards cancelled                | 1,584                            | (1,584)                            | 11.38                              |
| Additional shares reserved      | 304,000                          |                                    |                                    |
| Balance as of December 31, 2004 | 1,392,456                        | 96,998                             | \$ 11.51                           |
| Awards granted                  | (264,156)                        | 264,156                            | 12.09                              |
| Awards vested                   |                                  | (116,886)                          | 11.90                              |
| Awards cancelled                | 19,430                           | (19,430)                           | 12.29                              |
| Additional shares reserved      | 320,000                          |                                    |                                    |
| Balance as of December 30, 2005 | 1,467,730                        | 224,838                            | \$ 11.93                           |
| Awards granted                  | (205,068)                        | 205,068                            | 15.63                              |
| Awards vested                   |                                  | (100,146)                          | 15.31                              |
| Awards cancelled                | 7,642                            | (7,642)                            | 12.26                              |
| Additional shares reserved      | 320,000                          |                                    |                                    |
| Balance as of December 29, 2006 | 1,590,304                        | 322,118                            | \$ 13.22                           |

<sup>1</sup> Does not include employee stock purchase or stock option plans.

### Stock Option Plans

The 1999 Stock Option Plan was approved at the 1999 Stockholders Meeting. The 1999 Stock Option Plan is an incentive stock option plan, which provided initially for 800,000 shares to be available for grant. The plan includes a clause which states an annual increase can be added on each anniversary date of the adoption of the plan equal to the lesser of: 600,000 shares, 3% of outstanding shares on such date or an amount determined by the Board of Directors. The Board of Directors approved increases of 480,000 shares, 480,000 shares and

456,000 shares in 2006, 2005 and 2004, respectively. The plan provides for a grant of incentive stock options, non-statutory stock options and stock purchase rights at an exercise price equal to the fair market value of the shares at the date of grant. Options are granted for terms of up to ten years and generally vest ratably over a four-year period from the grant date. As of December 29, 2006, the Company has granted 2,355,000 options under the 1999 Stock Option Plan, 1,438,480 of which are outstanding.

The 1998 Stock Option Plan is a non-statutory stock option plan, which initially covered up to an aggregate of 600,000 shares of common stock. The 1998 Stock Option Plan provides for the grant of restricted stock or non-qualified options. The non-qualified options are exercisable at a price not less than 85% of the fair market value of the shares at the date of grant. Options are granted for terms of up to ten years and generally vest ratably over a four-year period from the grant date. As of December 29, 2006, the Company has granted 1,525,768 shares under the 1998 Stock Option Plan, of which 71,996 were restricted shares. There were 189,650 shares outstanding under this plan at December 29, 2006.

The 1990 Stock Option Plan is an incentive stock option plan, which covers up to an aggregate of 4,000,000 shares of common stock. This plan expired in 2000. The 1990 Stock Option Plan provided for the grant of either incentive stock options, exercisable at a price equal to the fair market value of the shares at the date of grant, or non-qualified options, exercisable at a price not less than 85% of the fair market value of the shares at the date of grant. All 4,000,000 shares have been granted, of which 713,229 shares were outstanding as of December 29, 2006.



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Option activity under the stock option plans is as follows<sup>1</sup>:

|                                                  | Options<br>available<br>for grant | Number<br>of shares<br>outstanding | Weighted-<br>average<br>exercise<br>price | Weighted-<br>average<br>remaining<br>contractual<br>term (years) | Aggregate<br>intrinsic<br>value (in<br>thousands) |
|--------------------------------------------------|-----------------------------------|------------------------------------|-------------------------------------------|------------------------------------------------------------------|---------------------------------------------------|
| Balance as of January 2, 2004                    | 731,232                           | 4,179,382                          | \$ 4.60                                   |                                                                  |                                                   |
| Options granted                                  | (155,000)                         | 155,000                            | 11.70                                     |                                                                  |                                                   |
| Options cancelled                                | 55,838                            | (55,838)                           | 4.62                                      |                                                                  |                                                   |
| Options exercised                                |                                   | (1,362,692)                        | 3.88                                      |                                                                  |                                                   |
| Additional shares reserved                       | 456,000                           |                                    |                                           |                                                                  |                                                   |
| Balance as of December 31, 2004                  | 1,088,070                         | 2,915,852                          | \$ 5.32                                   |                                                                  |                                                   |
| Options granted                                  | (110,000)                         | 110,000                            | 11.91                                     |                                                                  |                                                   |
| Options cancelled                                | 4,748                             | (7,248)                            | 5.49                                      |                                                                  |                                                   |
| Options exercised                                |                                   | (404,992)                          | 4.94                                      |                                                                  |                                                   |
| Additional shares reserved                       | 480,000                           |                                    |                                           |                                                                  |                                                   |
| Balance as of December 30, 2005                  | 1,462,818                         | 2,613,612                          | \$ 5.65                                   |                                                                  |                                                   |
| Options granted                                  | (75,000)                          | 75,000                             | 15.65                                     |                                                                  |                                                   |
| Options cancelled                                | 4,000                             | (5,500)                            | 5.24                                      |                                                                  |                                                   |
| Options exercised                                |                                   | (341,753)                          | 5.18                                      |                                                                  |                                                   |
| Additional shares Reserved                       | 480,000                           |                                    |                                           |                                                                  |                                                   |
| Balance as of December 29, 2006                  | 1,871,818                         | 2,341,359                          | \$ 6.04                                   | 4.18                                                             | \$ 29,552                                         |
| Vested and expected to vest at December 29, 2006 |                                   | 2,312,632                          | \$ 5.96                                   | 4.13                                                             | \$ 29,378                                         |
| Exercisable at December 29, 2006                 |                                   | 1,985,609                          | \$ 5.12                                   | 3.58                                                             | \$ 26,892                                         |

<sup>1</sup> Does not include restricted stock or employee stock purchase plans

The total intrinsic value of options exercised during the twelve month period ended December 29, 2006, December 30, 2005 and December 31, 2004 was \$3,785,000, 3,143,000 and \$11,452,000, respectively. The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the Company's closing stock price on the last trading day of the year ended

December 29, 2006, and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 29, 2006. This amount changes based on the fair-value of the Company's stock.

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Information regarding options outstanding at December 29, 2006 is summarized below:

| Range of<br>exercise price | Number<br>of<br>options | Outstanding                                        |                                           | Exercisable  |                                          |
|----------------------------|-------------------------|----------------------------------------------------|-------------------------------------------|--------------|------------------------------------------|
|                            |                         | Weighted-<br>average<br>remaining<br>life in years | Weighted-<br>average<br>exercise<br>price | of<br>shares | Weighted<br>average<br>exercise<br>price |
| \$2.88-\$3.61              | 626,724                 | 2.12                                               | \$ 3.28                                   | 626,724      | \$ 3.28                                  |
| \$3.75-\$5.09              | 562,655                 | 2.47                                               | \$ 4.49                                   | 562,655      | \$ 4.49                                  |
| \$5.48-\$6.57              | 481,480                 | 4.89                                               | \$ 6.19                                   | 472,730      | \$ 6.18                                  |
| \$6.65-\$7.68              | 345,500                 | 6.17                                               | \$ 7.09                                   | 245,500      | \$ 7.09                                  |
| \$11.31-\$15.65            | 325,000                 | 7.97                                               | \$ 12.70                                  | 78,000       | \$ 11.72                                 |
|                            | 2,341,359               | 4.18                                               | \$ 6.04                                   | 1,985,609    | \$ 5.12                                  |

**Restricted Stock Units**

The Company grants restricted stock units to employees and outside directors under the 1999 Restricted Stock Plan. These restricted stock unit grants are designed to attract and retain employees, and to better align employee interests with those of the Company's stockholders. For a select group of employees, up to 40% of their annual bonus is settled with fully vested restricted stock unit awards. Under these fully vested restricted stock unit awards, the holder of each award has the right to receive one share of the Company's common stock for each fully vested restricted stock unit four years from the date of grant. Each individual who received a fully vested restricted stock unit award is also granted a matching number of unvested restricted stock unit awards. These unvested restricted stock unit awards cliff vest four years from the date of grant, at which time the holder of each award will have the right to receive one share of the Company's common stock for each restricted stock unit award provided the holder of each award has met certain employment conditions. In the case of retirement at 59 1/2 years or older, all unvested restricted stock unit awards will continue to vest provided the holder of each award does all consulting work through the company and does not become an employee for a past or present client, beneficial party or competitor of the company.

The value of these restricted stock unit awards is determined based on the market price of the Company's common stock on the date of grant. The value of fully vested restricted stock unit awards issued is recorded as a reduction to accrued bonuses. The portion of bonus expense that the Company expects to settle with fully vested restricted stock unit awards is recorded as stock-based compensation during the period the bonus is earned. For the twelve months ended December 29, 2006, December 30, 2005 and December 31, 2004, the Company recorded stock-based compensation expense associated with

accrued bonus awards of \$2,217,000, \$1,450,000 and \$1,340,000, respectively. Prior to the adoption of FAS 123(R) the value of the unvested restricted stock unit awards was amortized on a straight-line basis over the four-year vesting period regardless of the age of the award recipient. Subsequent to the adoption of FAS 123(R) the value of these awards was amortized on a straight-line basis over the shorter of the four-year vesting period or the period between the grant date and the date the award recipient turns 59 1/2. If the award recipient was 59 1/2 years or older on the date of grant, the value of the entire award was expensed upon grant. Stock-based compensation cost recognized in fiscal 2006 that would have been recognized in prior years had the requisite service period provisions of SFAS 123(R) been applied to awards granted prior to 2006 was \$218,000.

The Company recorded stock-based compensation expense associated with the unvested restricted stock unit awards of \$1,223,000, \$604,000 and \$256,000 during the twelve months ended December 29, 2006, December 30, 2005 and December 31, 2004, respectively.

**Stock Options**

The Company currently grants stock options under the 1999 Stock Option Plan and the 1998 Stock Option Plan. Options are granted for terms of ten years and generally vest ratably over a four-year period from the grant date. The Company grants options at exercise prices equal to the fair value of the Company's common stock on the date of grant. During the twelve months ended December 29, 2006 the Company recorded stock-based compensation expense of \$862,000 associated with stock options granted prior to, but not yet vested as of December 30, 2005.

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During the twelve months ended December 29, 2006, the Company recorded stock-based compensation expense of \$112,000 associated with stock options granted during the twelve months

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ended December 29, 2006. There was no stock-based compensation expense associated with stock options recognized during the twelve months ended December 30, 2005 and December 31, 2004.

**Stock-Based Compensation**

Beginning with the first quarter of fiscal 2006, the Company adopted SFAS 123(R). See Note 1 for a description of the adoption of SFAS 123(R). The Company uses the Black-Scholes option-pricing model to determine the fair value of options granted. The determination of the fair value of stock-based payment awards on the date of grant using an option-pricing model is affected by the Company's stock price as well as assumptions regarding a number of complex and subjective variables. These variables include expected stock price volatility over the term of the award, actual and projected employee stock option exercise behaviors, the risk-free interest rate and expected dividends.

The Company used historical exercise and post-vesting forfeiture and expiration data to estimate the expected term of options granted. The historical volatility of the Company's common stock over a period of time equal to the expected term of the options granted was used to estimate expected volatility. The risk-free interest rate used in the option-pricing model was based on U.S. Treasury zero coupon issues with remaining terms similar to the expected term on the options. The Company does not anticipate paying any cash dividends in the foreseeable future and therefore used an expected dividend yield of zero in the option-pricing model. The Company is required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. Historical data was used to estimate pre-vesting option forfeitures and stock-based compensation expense was recorded only for those awards that are expected to vest. All share based payment awards are recognized on a straight-line basis over the requisite service periods of the awards.

The assumptions used to value option grants for the twelve months ended December 29, 2006, December 30, 2005 and December 31, 2004 are as follows:

|                                                                                                                                                                                            | <b>Stock Option Plan</b> |             |             |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------|-------------|-------------|
|                                                                                                                                                                                            | <b>2006</b>              | <b>2005</b> | <b>2004</b> |
| Expected life (in years)                                                                                                                                                                   | 6.6                      | 4.6         | 4.9         |
| Risk-free interest rate                                                                                                                                                                    | 4.6%                     | 4.3%        | 3.7%        |
| Volatility                                                                                                                                                                                 | 39%                      | 40%         | 47%         |
| Dividend yield                                                                                                                                                                             | 0%                       | 0%          | 0%          |
| The weighted-average fair value of options granted during the twelve months ended December 29, 2006, December 30, 2005 and December 31, 2004 were \$7.47, \$5.45 and \$6.22, respectively. |                          |             |             |

The amount of stock-based compensation expense recognized in our consolidated statements of income for the twelve months ended December 29, 2006, December 30, 2005 and December 31, 2004 is as follows:

| <b>(In thousands)</b>                | <b>2006</b> | <b>2005</b> | <b>2004</b> |
|--------------------------------------|-------------|-------------|-------------|
| Compensation and related expenses:   |             |             |             |
| Restricted stock units               | \$ 3,344    | \$ 1,985    | \$ 1,567    |
| Stock option grants                  | 974         |             |             |
| Sub-total                            | 4,318       | 1,985       | 1,567       |
| General and administrative expenses: |             |             |             |
| Restricted stock units               | 96          | 69          | 29          |
| Sub-total                            | 96          | 69          | 29          |

|                                        |          |          |          |
|----------------------------------------|----------|----------|----------|
| Total stock-based compensation expense | \$ 4,414 | \$ 2,054 | \$ 1,596 |
|----------------------------------------|----------|----------|----------|

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The following table sets forth the pro-forma amounts of net income and net income per share, for the twelve months ended December 30, 2005 and December 31, 2004, that would have resulted if the Company had accounted for its stock option plans under the fair value recognition provisions of SFAS 123(R):

| (In thousands, except per share data)                                  | 2005      | 2004      |
|------------------------------------------------------------------------|-----------|-----------|
| Reported net income:                                                   | \$ 14,186 | \$ 12,040 |
| Add back: Intrinsic value stock-based compensation expense, net of tax | 1,300     | 942       |
| Deduct: Fair value stock-based compensation expense, net of tax        | (2,878)   | (2,595)   |
| Adjusted net income:                                                   | \$ 12,608 | \$ 10,387 |
| Net income per share:                                                  |           |           |
| As reported:                                                           |           |           |
| Basic                                                                  | \$ 0.88   | \$ 0.78   |
| Diluted                                                                | \$ 0.81   | \$ 0.71   |
| Adjusted:                                                              |           |           |
| Basic                                                                  | \$ 0.78   | \$ 0.67   |
| Diluted                                                                | \$ 0.72   | \$ 0.62   |
| Shares used in per share calculations:                                 |           |           |
| As reported:                                                           |           |           |
| Basic                                                                  | 16,212    | 15,414    |
| Diluted                                                                | 17,538    | 17,074    |
| Adjusted:                                                              |           |           |
| Basic                                                                  | 16,212    | 15,414    |
| Diluted                                                                | 17,394    | 16,848    |

As of December 29, 2006, there was \$1.9 million of unrecognized compensation cost, expected to be recognized over a weighted average period of 2.5 years, related to unvested restricted stock unit awards and \$1.2 million of unrecognized compensation cost, expected to be recognized over a weighted average period of 3.1 years, related to unvested stock options. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures.

A summary of the Company's unvested stock options is as follows:

|                                                           | Unvested<br>options<br>outstanding | Weighted-<br>average<br>fair value |
|-----------------------------------------------------------|------------------------------------|------------------------------------|
| Balance of unvested stock options as of December 30, 2005 | 609,038                            | \$ 4.58                            |
| Options granted                                           | 75,000                             | 7.47                               |
| Options vested                                            | (326,788)                          | 4.37                               |
| Options forfeited                                         | (1,500)                            | 3.83                               |
| Balance of unvested stock options as of December 29, 2006 | 355,750                            | \$ 5.38                            |

**Note 10: Retirement Plans**

The Company provides a 401(k) plan for its employees whereby the Company contributes to each eligible employee's 401(k) account, 7% of the employee's eligible base salary plus overtime. The employee does not need to make a contribution to the plan to be eligible for the Company's 7% contribution. To be eligible under the plan, an employee must be at least 21 years of age and be either a full-time or part-time salaried employee. The 7% Company contribution will vest 20% per year for

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the first 5 years of employment and then immediately thereafter. The Company's expenses related to this plan were \$4,673,000, \$3,986,000 and \$4,026,000 in fiscal 2006, 2005 and 2004, respectively.

### **Note 11: Deferred Compensation Plan**

The Company maintains a nonqualified deferred compensation plan for the benefit of a select group of highly compensated employees. Under this plan participants may elect to defer up to 100% of their compensation. Net employee deferrals were \$720,000 and \$1,690,000 during fiscal years 2006 and 2005, respectively.

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In connection with the hiring of an executive officer in June 2006, the Company made a discretionary contribution of \$1,000,000 to the non-qualified deferred compensation plan. One-eighth of this contribution will vest on each three-month anniversary of this executive officer's date of hire, provided that this individual remains a full-time employee. The value of this contribution is recognized over the requisite service period on a straight-line basis. Compensation expense for this contribution was \$314,000 during fiscal 2006.

Company assets that are earmarked to pay benefits under the plan are held in a rabbi trust and are subject to the claims of the Company's creditors. As of December 29, 2006 and December 30, 2005, the invested amounts under the plan totaled \$5.7 million and \$3.4 million, respectively, and were recorded as a long-term asset on the Company's condensed consolidated balance sheet. These assets are classified as trading securities and are recorded at fair market value with changes recorded as adjustments to other income and expense. As of December 29, 2006 and December 30, 2005, vested amounts due under the plan totaled \$4.9 million and \$3.4 million, respectively, and were recorded as a long-term other liability on the Company's condensed consolidated balance sheet. Changes in the liability are recorded as adjustments to compensation expense. During the fiscal years 2006, 2005 and 2004, the Company recognized compensation expense of \$479,000, \$330,000 and \$110,000, respectively, as a result of an increase in the market value of the trust assets, with a corresponding amount being recorded as other income.

**Note 12: Inventory**

At December 29, 2006, the Company has \$520,000 and \$364,000 of finished goods and work-in-process inventory, respectively, included in prepaid expenses and other current assets in the accompanying balance sheet.

**Note 13: Commitments and Contingencies**

The following is a summary of the future minimum payments, net of sub-lease income, required under non-cancelable operating leases, with terms in excess of one year, as of December 29, 2006:

(In thousands)

| Fiscal year | Lease commitments | Sub-lease income | Total     |
|-------------|-------------------|------------------|-----------|
| 2007        | \$ 5,058          | \$ (329)         | \$ 4,729  |
| 2008        | 3,963             | (232)            | 3,731     |
| 2009        | 3,633             | (106)            | 3,527     |
| 2010        | 2,572             |                  | 2,572     |
| 2011        | 1,906             |                  | 1,906     |
| Thereafter  | 2,245             |                  | 2,245     |
|             | \$ 19,377         | \$ (667)         | \$ 18,710 |

As of December 29, 2006 the Company had outstanding purchase obligations of \$383,000.

Total rent expense from property leases in 2006, 2005 and 2004 was \$4,804,000, \$4,644,000 and \$4,671,000, respectively. Total expense from other operating leases and commitments in 2006, 2005 and 2004 was \$938,000, \$1,079,000 and \$1,018,000, respectively.

From time to time, the Company may be subject to legal and other claims that arise in the ordinary course of business. In the opinion of management, there are currently no matters that would have a material adverse effect on the Company's consolidated financial position, if unfavorably resolved.

**Note 14: Other Income, Net**

Interest and other income, net, consisted of the following:

Fiscal Years

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| (In thousands)                            | 2006     | 2005     | 2004     |
|-------------------------------------------|----------|----------|----------|
| Interest income                           | \$ 1,942 | \$ 1,218 | \$ 489   |
| Interest expense                          | (15)     | (13)     | (18)     |
| Rental income                             | 719      | 625      | 477      |
| Gain on deferred compensation investments | 581      | 330      | 110      |
| Other                                     | 162      | 78       | 21       |
| Total                                     | \$ 3,389 | \$ 2,238 | \$ 1,079 |

## Note 15: Client and Industry Credit Risk

The Company serves clients in various segments of the economy. During 2006, 2005 and 2004 the Company provided services representing approximately 17%, 20% and 21%, respectively, of revenues to clients and to organizations and insurers acting on behalf of clients in the transportation industry. In addition, during 2006, 2005 and 2004 the Company derived approximately 10%, 11% and 15%, respectively, of revenues from professional services provided to government agencies and contractors.

**Table of Contents****Note 16: Related Party Transactions**

The Company has a software licensing contract with an organization owned by the husband of one of Exponent's former Practice Directors. Exponent recorded software licensing fees and consulting expenses related to this contract of \$100,000, \$135,000 and \$165,000 during fiscal years 2006, 2005 and 2004, respectively. The terms of this contract call for a payment of \$100,000 in fiscal 2007.

**Note 17: Supplemental Cash Flow Information**

The following is supplemental disclosure of cash flow information:

| (In thousands)                                          | Fiscal Years |          |          |
|---------------------------------------------------------|--------------|----------|----------|
|                                                         | 2006         | 2005     | 2004     |
| Cash paid during the year:                              |              |          |          |
| Interest                                                | \$ 9         | \$ 8     | \$ 13    |
| Income taxes                                            | \$ 9,730     | \$ 8,891 | \$ 6,726 |
| Non-cash investing and financing activities:            |              |          |          |
| Capital leases for equipment                            | \$ 147       | \$ 11    | \$ 34    |
| Unrealized gain (loss) on short-term investments        | \$ 47        | \$ 5     | \$ (128) |
| Vested stock unit awards issued to settle accrued bonus | \$ 1,450     | \$ 1,342 | \$ 985   |

**Note 18: Segment Reporting**

The Company has two operating segments based on two primary areas of service. One operating segment is a broad service group providing technical consulting in different practices primarily in the areas of impending litigation and technology development. The Company's other operating segment provides services in the area of environmental, epidemiology and health risk analysis. This operating segment provides a wide range of consulting services relating to environmental hazards and risks and the impact on both human health and the environment.

Segment information is presented for selected data from the statements of income and statements of cash flows for fiscal years 2006, 2005 and 2004. Segment information for selected data from the balance sheets is presented for the fiscal years ended December 29, 2006 and December 30, 2005.

**Revenues**

| (In thousands)                   | Fiscal Years |            |            |
|----------------------------------|--------------|------------|------------|
|                                  | 2006         | 2005       | 2004       |
| Engineering and other scientific | \$ 130,960   | \$ 119,037 | \$ 115,558 |
| Environmental and health         | 37,536       | 36,159     | 35,951     |
| Total revenues                   | \$ 168,496   | \$ 155,196 | \$ 151,509 |

**Operating Income**

| (In thousands)                   | Fiscal Years |           |           |
|----------------------------------|--------------|-----------|-----------|
|                                  | 2006         | 2005      | 2004      |
| Engineering and other scientific | \$ 33,414    | \$ 27,943 | \$ 27,905 |
| Environmental and health         | 6,563        | 7,663     | 5,905     |

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|                                |           |           |           |
|--------------------------------|-----------|-----------|-----------|
| Total segment operating income | 39,977    | 35,606    | 33,810    |
| Corporate operating expense    | (19,788)  | (15,226)  | (14,486)  |
| Total operating income         | \$ 20,189 | \$ 20,380 | \$ 19,324 |

## Assets

| (In thousands)                   | Fiscal Years |            |
|----------------------------------|--------------|------------|
|                                  | 2006         | 2005       |
| Engineering and other scientific | \$ 63,022    | \$ 56,497  |
| Environmental and health         | 11,858       | 12,590     |
| Total segment assets             | 74,880       | 69,087     |
| Corporate assets                 | 86,336       | 95,154     |
| Total assets                     | \$ 161,216   | \$ 164,241 |

## Capital Expenditures

| (In thousands)                     | Fiscal Years |          |          |
|------------------------------------|--------------|----------|----------|
|                                    | 2006         | 2005     | 2004     |
| Engineering and other scientific   | \$ 2,026     | \$ 2,210 | \$ 1,949 |
| Environmental and health           | 356          | 134      | 123      |
| Total segment capital expenditures | 2,382        | 2,344    | 2,072    |
| Corporate capital expenditures     | 823          | 671      | 544      |
| Total capital expenditures         | \$ 3,205     | \$ 3,015 | \$ 2,616 |

**Table of Contents****Depreciation and Amortization**

| (In thousands)                              | Fiscal Years |          |          |
|---------------------------------------------|--------------|----------|----------|
|                                             | 2006         | 2005     | 2004     |
| Engineering and other scientific            | \$ 2,471     | \$ 2,324 | \$ 2,175 |
| Environmental and health                    | 164          | 169      | 172      |
| Total segment depreciation and amortization | 2,635        | 2,493    | 2,347    |
| Corporate depreciation and amortization     | 993          | 939      | 938      |
| Total depreciation and amortization         | \$ 3,628     | \$ 3,432 | \$ 3,285 |

Information regarding Exponent's operations in different geographical areas:

**Revenues <sup>1</sup>**

| (In thousands)    | Fiscal Years |            |            |
|-------------------|--------------|------------|------------|
|                   | 2006         | 2005       | 2004       |
| United States     | \$ 155,947   | \$ 145,510 | \$ 142,305 |
| Foreign Countries | 12,549       | 9,686      | 9,204      |
| Total             | \$ 168,496   | \$ 155,196 | \$ 151,509 |

**Property, Equipment and Leasehold Improvements, net**

| (In thousands)    | Fiscal Years |           |
|-------------------|--------------|-----------|
|                   | 2006         | 2005      |
| United States     | \$ 29,223    | \$ 29,716 |
| Foreign Countries | 354          | 123       |
| Total             | \$ 29,577    | \$ 29,839 |

<sup>1</sup> Geographic revenues are allocated based on the location of the client.

No single customer comprised more than 10% of the Company's revenues for the years ended December 29, 2006 and December 30, 2005. The Company derived 11% of revenues from agencies of the United States federal government for the year ended December 31, 2004. No single customer comprised more than 10% of the Company's accounts receivable at December 29, 2006 and December 30, 2005.

**Table of Contents****Comparative Quarterly Financial Data (unaudited)**

Summarized quarterly financial data is as follows:

**Fiscal 2006**

|                                              | <b>March 31,<br/>2006</b> | <b>June 30,<br/>2006</b> | <b>September 29,<br/>2006</b> | <b>December 29,<br/>2006</b> |
|----------------------------------------------|---------------------------|--------------------------|-------------------------------|------------------------------|
| <b>(In thousands, except per share data)</b> |                           |                          |                               |                              |
| Revenues before reimbursements               | \$ 39,619                 | \$ 39,053                | \$ 40,049                     | \$ 38,021                    |
| Revenues                                     | 42,027                    | 41,654                   | 43,333                        | 41,482                       |
| Operating income                             | 5,390                     | 5,328                    | 5,603                         | 3,868                        |
| Income before income taxes                   | 6,266                     | 5,984                    | 6,411                         | 4,917                        |
| Net income                                   | \$ 3,822                  | \$ 3,650                 | \$ 3,743                      | \$ 2,979                     |
| Net income per share                         |                           |                          |                               |                              |
| Basic                                        | \$ 0.23                   | \$ 0.22                  | \$ 0.24                       | \$ 0.20                      |
| Diluted                                      | \$ 0.21                   | \$ 0.21                  | \$ 0.22                       | \$ 0.18                      |
| Shares used in per share computations        |                           |                          |                               |                              |
| Basic                                        | 16,496                    | 16,357                   | 15,570                        | 15,107                       |
| Diluted                                      | 17,788                    | 17,631                   | 16,837                        | 16,455                       |

**Fiscal 2005**

|                                              | <b>April 1,<br/>2005</b> | <b>July 1,<br/>2005</b> | <b>September<br/>30,<br/>2005</b> | <b>December<br/>30,<br/>2005</b> |
|----------------------------------------------|--------------------------|-------------------------|-----------------------------------|----------------------------------|
| <b>(In thousands, except per share data)</b> |                          |                         |                                   |                                  |
| Revenues before reimbursements               | \$ 36,929                | \$ 36,674               | \$ 34,653                         | \$ 34,605                        |
| Revenues                                     | 39,196                   | 39,850                  | 37,192                            | 38,958                           |
| Operating income                             | 6,055                    | 6,271                   | 4,623                             | 3,431                            |
| Income before income taxes                   | 6,403                    | 6,777                   | 5,283                             | 4,155                            |
| Net income                                   | \$ 3,867                 | \$ 4,094                | \$ 3,515                          | \$ 2,710                         |
| Net income per share                         |                          |                         |                                   |                                  |
| Basic                                        | \$ 0.24                  | \$ 0.25                 | \$ 0.22                           | \$ 0.17                          |
| Diluted                                      | \$ 0.22                  | \$ 0.23                 | \$ 0.20                           | \$ 0.15                          |
| Shares used in per share computations        |                          |                         |                                   |                                  |
| Basic                                        | 16,046                   | 16,160                  | 16,291                            | 16,346                           |
| Diluted                                      | 17,346                   | 17,438                  | 17,650                            | 17,690                           |

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.

EXPONENT, INC.  
(Registrant)

Date: March 7, 2007

/s/ Richard L. Schlenker, Jr.  
Richard L. Schlenker, Jr., Chief Financial Officer and  
Corporate Secretary

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

| <b>Signature</b>              | <b>Title</b>                                    | <b>Date</b>   |
|-------------------------------|-------------------------------------------------|---------------|
| /s/ Michael R. Gaulke         | Chief Executive Officer, President and Director | March 7, 2007 |
| Michael R. Gaulke             |                                                 |               |
| /s/ Richard L. Schlenker, Jr. | Chief Financial Officer and Corporate Secretary | March 7, 2007 |
| Richard L. Schlenker, Jr.     | (Principal Financial and Accounting Officer)    |               |
| /s/ Leslie G. Denend          | Chairman of the Board of Directors              | March 7, 2007 |
| Leslie G. Denend              |                                                 |               |
| /s/ Roger L. McCarthy         | Chairman Emeritus and Director                  | March 7, 2007 |
| Roger L. McCarthy             |                                                 |               |
| /s/ Samuel H. Armacost        | Director                                        | March 7, 2007 |
| Samuel H. Armacost            |                                                 |               |
| /s/ Barbara M. Barrett        | Director                                        | March 7, 2007 |
| Barbara M. Barrett            |                                                 |               |
| /s/ Jon R. Katzenbach         | Director                                        | March 7, 2007 |
| Jon R. Katzenbach             |                                                 |               |
| /s/ Stephen C. Riggins        | Director                                        | March 7, 2007 |
| Stephen C. Riggins            |                                                 |               |

**Table of Contents****Schedule II****Valuation and Qualifying Accounts**

|                              |              | Additions  |            | Deletions <sup>1</sup> |           |
|------------------------------|--------------|------------|------------|------------------------|-----------|
|                              | Balance at   | Provision  | Provision  | Accounts               | Balance   |
| (In thousands)               | Beginning of | Charged to | Charged to | Written-off            | at End of |
|                              | Year         | Expense    | Revenues   | Net of                 | Year      |
|                              |              |            |            | Recoveries             |           |
| Year Ended December 29, 2006 |              |            |            |                        |           |
| Allowance for Bad Debt       | \$ 513       | \$ 199     | \$         | \$ (120)               | \$ 592    |
| Allowance for Revenue        | \$ 709       | \$         | \$ 1,435   | \$ (943)               | \$ 1,201  |
| Year Ended December 30, 2005 |              |            |            |                        |           |
| Allowance for Bad Debt       | \$ 513       | \$ 437     | \$         | \$ (437)               | \$ 513    |
| Allowance for Revenue        | \$ 990       | \$         | \$ 718     | \$ (999)               | \$ 709    |
| Year Ended December 31, 2004 |              |            |            |                        |           |
| Allowance for Bad Debt       | \$ 561       | \$ 625     | \$         | \$ (673)               | \$ 513    |
| Allowance for Revenue        | \$ 687       | \$         | \$ 1,222   | \$ (919)               | \$ 990    |

<sup>1</sup> Balance includes currency translation adjustments.

Recoveries of accounts receivable were \$58,000, \$133,000 and \$127,000 for the years ended December 29, 2006, December 30, 2005 and December 31, 2004, respectively.

Schedules other than above have been omitted since they are either not required, not applicable, or the information is otherwise included in the Report.

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### EXHIBIT INDEX

The following exhibits are filed as part of, or incorporated by reference into (as indicated parenthetically), the Annual Report on Form 10-K:

- 3.1(i) Restated Certificate of Incorporation of the Company (incorporated by reference from the Company's Registration Statement on Form S-1 as filed on June 25, 1990, registration number 33-35562).
- 3.1(ii) Certificate of Amendment of Restated Certificate of Incorporation of the Company (incorporated by reference from the Company's Current Report on Form 8-K filed on May 24, 2006).
- 3.2 Amended and Restated Bylaws of the Company (incorporated by reference from the Company's Registration statement on Form S-1 as filed on June 25, 1990, registration number 33-35562).
- 4.1 Specimen copy of Common Stock Certificate of the Company (incorporated by reference from the Company's Registration Statement on Forms S-1 as filed on June 25, 1990, registration number 33-35562).
- \*10.1 1990 Stock Option and Rights Plan, as amended through March 31, 1993 (incorporated by reference from the Company's Annual Report on Form 10-K for the fiscal year ended May 28, 1993).
- \*10.2 Form of Incentive Stock Option Agreement under the 1990 Stock Option and Rights Plan (incorporated by reference from the Company's Registration Statement on Form S-1 as filed on June 25, 1990, registration number 33-35562).
- \*10.3 Form of Nonqualified Stock Option Agreement under the 1990 Stock Option and Rights Plan (incorporated by reference from the Company's Registration Statement on Form S-1 as filed on June 25, 1990, registration number 33-35562).
- \*10.4 Form of Indemnification Agreement entered into or proposed to be entered into between the Company and its officers and directors (incorporated by reference from the Company's Registration Statement on Form S-1 as filed on June 25, 1990, registration number 33-35562).
- 10.5 Zarnowicka Elektrownia Gazowa, joint venture, dated September 8, 1994 (incorporated by reference from the Company's Annual Report on Form 10-K for the fiscal year ended December 30, 1994).
- \*10.6 Exponent, Inc. 1998 Non Statutory Stock Option Plan dated October 24, 1998 (incorporated by reference from the Company's Annual Report on Form 10-K for the fiscal year ended January 1, 1999).
- 10.7 Revolving reducing note with Wells Fargo Bank dated January 27, 1999 (incorporated by reference from the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999).
- 10.8 Exponent, Inc. 401(k) Savings Plan dated March 1, 1998 and restated effective January 2, 1999 (incorporated by reference from the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999).

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- 10.9 Exponent, Inc. Employee Stock Purchase Plan, as amended and restated December 8, 2005 (incorporated by reference from the Company's Annual Report on Form 10-K for the fiscal year ended December 30, 2005).
- 10.10 Exponent, Inc. 1999 Stock Option Plan (incorporated by reference from the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999).
- \*10.11 Exponent, Inc. 1999 Restricted Stock Plan (incorporated by reference from the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999).
- 10.12 First Amendment to Exponent, Inc. 401(k) Savings Plan dated March 1, 1998 and restated effective January 2, 1999 (incorporated by reference from the Company's Annual Report on Form 10-K for the fiscal year ended December 28, 2001).
- 10.13 Second Amendment to Exponent, Inc. 401(k) Savings Plan dated March 1, 1998 and restated effective January 2, 1999 (incorporated by reference from the Company's Annual Report on Form 10-K for the fiscal year ended December 28, 2001).
- 10.14 Third Amendment to Exponent, Inc. 401(k) Savings Plan dated March 1, 1998 and restated effective January 2, 1999 (incorporated by reference from the Company's Annual Report on Form 10-K for the fiscal year ended January 3, 2003).
- 10.15 Commercial Lease No. 03-53542 between the Company and the Arizona State Land Department, effective January 17, 1998 (incorporated by reference from the Company's Annual Report on Form 10-K for the fiscal year ended January 3, 2003).
- 10.16 Fourth Amendment to Exponent, Inc. 401(k) Savings Plan dated March 1, 1998 and restated effective January 2, 1999 (incorporated by reference from the Company's Annual Report on Form 10-K for the fiscal year ended January 2, 2004).
- \*10.17 Exponent Nonqualified Deferred Compensation Plan (incorporated by reference from the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2004).
- 10.18 Fifth Amendment to Exponent, Inc. 401(k) Savings Plan dated March 1, 1998 and restated effective January 2, 1999 (incorporated by reference from the Company's Annual Report on Form 10-K for the fiscal year ended December 30, 2005).
- \*10.19 Form of Indemnification Agreement entered into or proposed to be entered into between the Company and its officers and directors (incorporated by reference from the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2006).
- 10.20 Services Agreement between the Company and Exponent Engineering P.C. (incorporated by reference from the Company's Quarterly Report on Form 10-Q for the fiscal period ended March 31, 2006).
- \*10.21 Employment Offer Letter between the Company and Dr. Elizabeth Anderson (incorporated by reference from the Company's Current Report on Form 8-K filed on August 9, 2006).
- \*10.22 Employment Agreement between the Company and Roger L. McCarthy (incorporated by reference from the Company's Current Report on Form 8-K filed on January 16, 2007).

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|       |                                                                                                                   |
|-------|-------------------------------------------------------------------------------------------------------------------|
| 10.23 | Sixth Amendment to Exponent, Inc. 401(k) Savings Plan dated March 1, 1998 and restated effective January 2, 1999. |
| 10.24 | Amendment No. 1 to Exponent, Inc. 1998 Nonstatutory Stock Option Plan dated January 29, 2007.                     |
| 10.25 | Amendment No. 1 to Exponent, Inc. 1999 Stock Option Plan dated January 29, 2007.                                  |
| 10.26 | Amendment No. 1 to Exponent, Inc. 1999 Restricted Stock Plan dated January 29, 2007.                              |
| 21.1  | List of subsidiaries.                                                                                             |
| 23.1  | Independent Registered Public Accounting Firm's Consent.                                                          |
| 31.1  | Certification of Chief Executive Officer as required by Rule 13a-14(a) of the Securities Exchange Act of 1934.    |
| 31.2  | Certification of Chief Financial Officer as required by Rule 13a-14(a) of the Securities Exchange Act of 1934.    |
| 32.1  | Certification of Chief Executive Officer as required by Rule 13a-14(b) of the Securities Exchange Act of 1934.    |
| 32.2  | Certification of Chief Financial Officer as required by Rule 13a-14(b) of the Securities Exchange Act of 1934.    |

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\* Indicates management compensatory plan, contract or arrangement.