

Towers Watson & Co.
Form 10-Q
November 09, 2015

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2015

OR

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

For the transition period from _____ to _____

Commission File Number: 001-34594

TOWERS WATSON & CO.

(Exact name of registrant as specified in its charter)

Delaware	27-0676603
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
901 N. Glebe Road Arlington, VA	22203
(Address of principal executive offices)	(zip code)
(703) 258-8000	
(Registrant's telephone number, including area code)	

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

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

As of October 30, 2015, there were 69,443,969 outstanding shares of Class A Common Stock at a par value of \$0.01 per share.

TOWERS WATSON & CO.
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

TOWERS WATSON & CO.

Condensed Consolidated Statements of Operations

(In thousands of U.S. dollars, except share and per share data)

(Unaudited)

	Three Months Ended September	
	30,	
	2015	2014
Revenue	\$895,621	\$878,107
Costs of providing services:		
Salaries and employee benefits	544,472	533,528
Professional and subcontracted services	65,112	62,205
Occupancy	31,745	36,073
General and administrative expenses	71,370	75,434
Depreciation and amortization	44,192	44,869
Transaction and integration expenses	9,330	—
	766,221	752,109
Income from operations	129,400	125,998
Income from affiliates	51	—
Interest income	1,192	1,063
Interest expense	(2,072)	(2,328)
Other non-operating income	55,370	831
INCOME BEFORE INCOME TAXES	183,941	125,564
Provision for income taxes	60,558	44,062
NET INCOME BEFORE NON-CONTROLLING INTERESTS	123,383	81,502
Less: Income/(loss) attributable to non-controlling interests	1	(56)
NET INCOME (attributable to common stockholders)	\$123,382	\$81,558
Earnings per share:		
Basic earnings per share (attributable to common stockholders)	\$1.78	\$1.16
Diluted earnings per share (attributable to common stockholders)	\$1.78	\$1.16
Dividends declared per share	\$0.15	\$0.15
Weighted average shares of common stock, basic (000)	69,381	70,182
Weighted average shares of common stock, diluted (000)	69,475	70,596
See accompanying notes to the condensed consolidated financial statements		

TOWERS WATSON & CO.

Condensed Consolidated Statements of Comprehensive Income

(In thousands of U.S. dollars)

(Unaudited)

	Three Months Ended September 30,	
	2015	2014
Net income before non-controlling interests	\$123,383	\$81,502
Other comprehensive income/(loss), net of tax:		
Foreign currency translation	(71,558	) (105,331
Defined pension and post-retirement benefit costs	4,768	2,875
Hedge effectiveness	(802	) 806
Available-for-sale securities	(82	) (128
Other comprehensive income/(loss) before non-controlling interests	(67,674	) (101,778
Comprehensive income/(loss) before non-controlling interests	55,709	(20,276
Comprehensive income/(loss) attributable to non-controlling interest	(5	) (111
Comprehensive income/(loss) (attributable to common stockholders)	\$55,714	\$(20,165
See accompanying notes to the condensed consolidated financial statements		

TOWERS WATSON & CO.

Condensed Consolidated Balance Sheets

(In thousands of U.S. dollars, except share data)

(Unaudited)

	September 30, 2015	June 30, 2015
Assets		
Cash and cash equivalents	\$699,966	\$715,151
Fiduciary assets	33,054	38,075
Short-term investments	59,444	127,156
Receivables from clients:		
Billed, net of allowances of \$11,623 and \$7,665	481,271	479,536
Unbilled, at estimated net realizable value	332,551	320,827
	813,822	800,363
Other current assets	122,962	155,487
Total current assets	1,729,248	1,836,232
Fixed assets, net	396,967	390,681
Deferred income taxes	61,515	62,772
Goodwill	2,229,560	2,278,351
Intangible assets, net	642,900	654,087
Other assets	204,164	172,051
Total Assets	\$5,264,354	\$5,394,174
Liabilities		
Accounts payable, accrued liabilities and deferred income	\$398,088	\$424,403
Employee-related liabilities	339,094	581,115
Fiduciary liabilities	33,054	38,075
Term loan - current	25,000	25,000
Other current liabilities	42,922	62,281
Total current liabilities	838,158	1,130,874
Revolving credit facility	160,000	40,000
Term loan	168,750	175,000
Accrued retirement benefits and other employee-related liabilities	628,139	648,655
Professional liability claims reserve	237,074	235,856
Other noncurrent liabilities	234,652	216,277
Total Liabilities	2,266,773	2,446,662
Commitments and contingencies		
Stockholders' Equity		
Class A Common Stock — \$0.01 par value: 300,000,000 shares authorized; 74,552,661 issued and 69,441,212 and 69,281,754 outstanding	746	746
Additional paid-in capital	1,862,634	1,870,745
Treasury stock, at cost — 5,111,449 and 5,270,907 shares	(416,309)	(429,286)
Retained earnings	2,178,980	2,066,104
Accumulated other comprehensive loss	(643,966)	(576,298)
Total Stockholders' Equity	2,982,085	2,932,011
Non-controlling interest	15,496	15,501
Total Equity	2,997,581	2,947,512
Total Liabilities and Total Equity	\$5,264,354	\$5,394,174
See accompanying notes to the condensed consolidated financial statements		

TOWERS WATSON & CO.

Condensed Consolidated Statements of Cash Flows

(In thousands of U.S. dollars)

(Unaudited)

	Three Months Ended September	
	30,	
	2015	2014
Cash flows used in operating activities:		
Net income before non-controlling interests	\$ 123,383	\$ 81,502
Adjustments to reconcile net income to net cash from operating activities:		
Provision for doubtful receivables from clients	8,232	7,994
Depreciation	27,323	27,332
Amortization of intangible assets	16,869	17,537
Gain on sale of business, pretax	(55,390))
Provision for deferred income taxes	45,395	25,893
Stock-based compensation	3,734	11,174
Other, net	245	975
Changes in operating assets and liabilities (net of business acquisitions)		
Receivables from clients	(40,693	) (960
Fiduciary assets	5,015	(3,655
Other current assets	(15,501	) (24,418
Other noncurrent assets	(984	) (4,240
Accounts payable, accrued liabilities and deferred income	(37,107	) (59,649
Employee-related liabilities	(237,044	) (173,084
Fiduciary liabilities	(5,015	) 3,655
Accrued retirement benefits and other employee-related liabilities	(38,788	) (65,744
Professional liability claims reserves	3,955	4,995
Other current liabilities	4,224	5,255
Other noncurrent liabilities	1,147	(9,299
Income tax related accounts	30,428	(50,445
Cash flows used in operating activities	(160,572	) (205,182
Cash flows from/(used in) investing activities:		
Cash paid for business acquisitions	(15,964	) (1,255
Net proceeds from sale of business	65,264	—
Fixed assets and software for internal use	(15,002	) (15,714
Capitalized software costs	(21,189	) (17,900
Purchases of held-to-maturity investments	(12,632	) (127,431
Redemptions of held-to-maturity investments	74,153	107,330
Purchases of available-for-sale securities	(207	) (11
Sales and redemptions of available-for-sale securities	—	11,721
Cash flows from/(used in) investing activities	74,423	(43,260
Cash flows from financing activities:		
Borrowings under credit facility	384,500	145,000
Repayments under credit facility	(294,500	) (10,000
Repayments of notes payable	(6,250	) (6,250
Cash paid on retention liability	—	(284
Dividends paid	(10,506	) (9,723
Repurchases of common stock	—	(37,350
Payroll tax payments on vested shares	(12,039) (10,363

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Issuances of common stock and excess tax benefit	12,065	4,229
Other financing activities	15,000	—
Cash flows from financing activities	88,270	75,259
Effect of exchange rates on cash	(17,306	) (11,316)
Decrease in cash and cash equivalents	(15,185	) (184,499)
Cash and cash equivalents at beginning of period	715,151	727,849
Cash and cash equivalents at end of period	\$699,966	\$543,350
Supplemental disclosures:		
Cash paid for interest	\$906	\$809
Cash (refunded)/paid for income taxes, net of refunds	\$(26,412	) \$63,796
Common stock issued upon the vesting of our restricted stock units	\$20,261	\$8,246
See accompanying notes to the condensed consolidated financial statements		

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TOWERS WATSON & CO.

Condensed Consolidated Statements of Changes in Stockholders' Equity

(In thousands of U.S. Dollars and numbers of shares in thousands)

(Unaudited)

	Class A Common Stock Outstanding	Class A Common Stock	Additional Paid-in Capital	Treasury Stock, at Cost	Retained Earnings	Accumulated Other Comprehensive (Loss)/Income	Non- Controlling Interest	Total
Balance as of June 30, 2014	74,552	\$ 746	\$ 1,849,119	\$(286,182)	\$ 1,722,927	\$(189,702)	\$ 14,041	\$ 3,110,949
Net income	—	—	—	—	81,558	—	(56)	81,502
Other comprehensive income/(loss)	—	—	—	—	—	(101,723)	(55)	(101,778)
Repurchases of common stock	—	—	—	(37,350)	—	—	—	(37,350)
Shares received for employee taxes upon vesting of restricted stock units	—	—	—	(6,672)	—	—	—	(6,672)
Exercises of stock options	—	—	(854)	854	—	—	—	—
Vesting of restricted stock units	—	—	(8,303)	8,246	—	—	—	(57)
Class A Common Stock:								
Cash dividends declared	—	—	—	—	(10,508)	—	—	(10,508)
Excess tax benefits	—	—	4,229	—	—	—	—	4,229
Stock-based compensation	—	—	11,174	—	—	—	—	11,174
Balance as of September 30, 2014	74,552	\$ 746	\$ 1,855,365	\$(321,104)	\$ 1,793,977	\$(291,425)	\$ 13,930	\$ 3,051,489
Balance as of June 30, 2015	74,552	\$ 746	\$ 1,870,745	\$(429,286)	\$ 2,066,104	\$(576,298)	\$ 15,501	\$ 2,947,512
Net income	—	—	—	—	123,382	—	1	123,383
Other comprehensive loss	—	—	—	—	—	(67,668)	(6)	(67,674)
Repurchases of common stock	—	—	—	—	—	—	—	—
Shares received for employee taxes upon vesting of restricted stock units	—	—	—	(8,213)	—	—	—	(8,213)
Exercises of stock options	—	—	(938)	929	—	—	—	(9)
Vesting of restricted stock units	—	—	(22,292)	20,261	—	—	—	(2,031)

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Class A Common

Stock:

Cash dividends declared—	—	—	—	(10,506)	—	—	(10,506)
Excess tax benefits	—	—	11,450	—	—	—	—	11,450	
Stock-based compensation	—	—	3,669	—	—	—	—	3,669	
Balance as of September 30, 2015	74,552	\$ 746	\$ 1,862,634	\$(416,309)	\$ 2,178,980	\$(643,966)	\$ 15,496	\$ 2,997,581	

See accompanying notes to the condensed consolidated financial statements

TOWERS WATSON & CO.

Notes to the Condensed Consolidated Financial Statements

(Tabular amounts are in thousands, except per share data)

(Unaudited)

Note 1 — Organization, Basis of Presentation and Proposed Merger

The accompanying unaudited quarterly condensed consolidated financial statements of Towers Watson & Co.

(“Towers Watson”, the “Company” or “we”) and our subsidiaries are presented in accordance with the rules and regulations of the Securities and Exchange Commission (“SEC”) for quarterly reports on Form 10-Q and therefore do not include all of the information and footnotes required by U.S. generally accepted accounting principles (“GAAP”). In the opinion of management, these condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, which are necessary for a fair presentation of the condensed consolidated financial statements and results for the interim periods. All intercompany accounts and transactions have been eliminated in consolidation. The condensed consolidated financial statements should be read together with the Towers Watson audited consolidated financial statements and notes thereto contained in the Company’s Annual Report on Form 10-K for the fiscal year ended June 30, 2015, which was filed with the SEC on August 14, 2015, and may be accessed via EDGAR on the SEC’s web site at www.sec.gov.

Our fiscal year 2016 began July 1, 2015 and ends June 30, 2016.

The results of operations for the three months ended September 30, 2015 are not necessarily indicative of the results that can be expected for the entire fiscal year ending June 30, 2016. The results reflect certain estimates and assumptions made by management including those estimates used in calculating acquisition consideration and fair value of tangible and intangible assets and liabilities, professional liability claims, estimated bonuses, valuation of billed and unbilled receivables, and anticipated tax liabilities that affect the amounts reported in the condensed consolidated financial statements and related notes.

Proposed Merger

On June 30, 2015, Willis Group Holdings PLC (“Willis”) and Towers Watson announced the signing of a definitive merger agreement under which the companies will combine in an all-stock merger of equals transaction (“Towers Watson | Willis Merger”). Based on the closing price of Willis and Towers Watson common stock on June 29, 2015, the implied equity value of the transaction is approximately \$18 billion. At the effective time of the Towers Watson | Willis Merger, each share of Class A common stock, par value \$0.01 per share, of Towers Watson (the “TW Common Stock”) issued and outstanding immediately prior to the Towers Watson | Willis Merger (other than shares held by Towers Watson, Willis, or Merger Sub and dissenting shares) will be converted into the right to receive 2.6490 validly issued, fully paid and nonassessable ordinary shares of Willis. In addition, Towers Watson intends to declare and pay a pre-Towers Watson | Willis Merger special dividend of \$4.87 per share of TW Common Stock, payable to holders of record of TW Common Stock prior to the closing date. We are in the process of evaluating our options to fund the special dividend. The transaction is expected to close by December 31, 2015, subject to customary closing conditions, including regulatory approvals, and approval by both Willis shareholders and Towers Watson stockholders.

Recent Accounting Pronouncements

Not yet adopted

On May 28, 2014, the Financial Accounting Standards Board (“FASB”) and International Accounting Standards Board (“IASB”) issued their final standard on revenue from contracts with customers. The standard, issued as Accounting Standards Update (“ASU”) 2014-09 by the FASB, outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers, and supersedes most current revenue recognition guidance. The core principle of the revenue model is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU applies to all contracts with customers, except those that are within the scope of other topics in the FASB Accounting Standards Codification. Compared with current U.S. GAAP, the ASU also requires significantly expanded disclosures about revenue recognition. The ASU was originally effective for interim and annual reporting periods that begin after December 15, 2016, and early adoption is prohibited. However, the FASB issued ASU 2015-14 on August 12, 2015, which defers the adoption date for one year

and allows for early adoption. ASU 2014-09 is now effective for interim and annual reporting periods that begin after December 15, 2017. The Company is currently evaluating the impact of adopting this provision.

On June 19, 2014, the FASB issued ASU 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide a Performance Target Could Be Achieved After the Requisite Service Period. The ASU is intended to resolve the diverse

accounting treatment of these types of awards in practice. The amendments require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in “Compensation - Stock Compensation (Topic 718)” as it relates to awards with performance conditions that affect vesting to account for such awards. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved, and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The ASU is effective for interim and annual reporting periods that begin after December 15, 2015. The Company does not expect the adoption of this pronouncement to have an impact on our financial statements as this guidance mirrors our existing policy for such share-based awards.

On September 25, 2015, the FASB issued ASU 2015-16, Business Combinations, Simplifying the Accounting for Measurement Period Adjustments. The ASU eliminates the requirement that an acquirer in a business combination account for measurement-period adjustments retrospectively. Instead, an acquirer will recognize a measurement-period adjustment during the period in which it determines the amount of the adjustment, including the effect on earnings of any amounts it would have recorded in previous periods if the accounting had been completed at the acquisition date. The ASU is effective for interim and annual periods that begin after December 15, 2015. The Company is currently evaluating the impact of adopting this provision.

Note 2 — Acquisitions and Divestitures

Acquisitions

Acclaris Acquisition

On May 11, 2015, Towers Watson acquired Acclaris Holdings, Inc. (“Acclaris”) for \$140.0 million in cash. Headquartered in Tampa, FL, and with locations in Kansas and India, Acclaris offers flexible products that include integrated technology and services to support consumer-directed benefits on a single platform in a scalable way. Its core business focuses on health care and reimbursement accounts which include health reimbursement arrangements (HRAs), health savings accounts (HSAs), flexible spending accounts, commuter accounts and custom reimbursement accounts. Acclaris was integrated into our Exchange Solutions segment and joined the Other line of business as the Consumer-Directed Accounts practice. Together, Towers Watson and Acclaris enable clients of any size to offer benefits in new and cost-effective ways.

During the fourth quarter of fiscal year 2015, we recorded the tangible assets received, liabilities assumed, and the fair value of intangibles. The intangibles included developed technology, valued at \$14.5 million, and a customer related intangible, valued at \$12.3 million. Our estimate of fair value for the developed technology intangible and the customer related intangible was based on the relief from royalty method and the multi-period excess earnings method, respectively. Significant assumptions used in the valuation were estimated revenues and expenses, contributory asset charges, required rates of return, and discount rates. During the first quarter of fiscal year 2016, working capital and acquisition accounting adjustments were made resulting in a refund of \$1.7 million of cash consideration and a \$3.1 million decrease to goodwill. It was determined that total consideration was \$139.5 million, and we recorded \$109.2 million of goodwill related to the acquisition of Acclaris.

Saville Consulting Acquisition

On April 23, 2015, Towers Watson acquired Saville Consulting Group Limited (“Saville”) for £42.0 million (\$64.5 million) in cash. Saville is a U.K. and Jersey-based global psychometric assessment business. Its principal activities include helping employers to improve the match between people, work and organizations through the development and sale of objective psychometric assessment tools and related user training and consultancy services. Saville is included within our Data, Surveys and Technology line of business within our Talent and Rewards segment. During the fourth quarter of fiscal 2015, we recorded the tangible assets received, liabilities assumed, and the fair value of intangibles. The intangibles included a product intangible, valued at £25.8 million, and other intangibles that were collectively immaterial. Our estimate of fair value for the product intangible was based on the relief from royalty method. Significant assumptions used in the valuation were estimated revenues and expenses, contributory asset

charges, required rates of return, and discount rates. It was determined that total consideration was £43.4 million, and we recorded £5.8 million of goodwill related to the acquisition of Saville, inclusive of £0.6 million of deferred consideration recorded in the first quarter of fiscal year 2016.

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Divestitures

Sale of Human Resources Service Delivery Practice

On July 9, 2015, we entered into a definitive agreement with KPMG to sell our Human Resources Service Delivery (“HRSD”) practice. The sale closed on August 14, 2015 for proceeds of \$65.8 million, which reflects working capital adjustments and excludes transaction costs. The HRSD practice was a component of our Talent and Rewards segment. We divested this business to enhance our focus on other targeted areas like software offerings, integrating the Saville Consulting acquisition, and continuing to drive market leadership of our core businesses.

ASU 2014-08, Presentation of Financial Statements and Property, Plant, and Equipment - Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, amended the requirements for the presentation of discontinued operations in the financial statements. Discontinued operations that do not represent a strategic shift or will not have a major effect on an entity’s operations and financial results are no longer reported in discontinued operations and are only disclosed in the notes to the financial statements. The divestiture